

o. 85-1967-ASX Title: Tyler Pipe Industries, Inc., Appellant
 status: GRANTED v.
 Washington Department of Revenue
 docketed: Court: Supreme Court of Washington
 May 30, 1986 Counsel for appellant: O'Brien, Neil J.
 side: 25-2006 Counsel for appellee: Collins, William Berggren

Entry	Date	Note	Proceedings and Orders
1	May 30 1986	S	Statement as to jurisdiction filed.
3	Jun 19 1986		Order extending time to file response to jurisdictional statement until July 16, 1986.
4	Jul 16 1986		DISTRIBUTED. September 29, 1986
5	Jul 16 1986	X	Motion of appellee WA Dept. of Revenue to dismiss or affirm filed.
6	Aug 8 1986	X	Reply brief of appellant Tyler Pipe Industries filed.
7	Oct 6 1986		PROBABLE JURISDICTION NOTED. The case is consolidated with 85-2006, and a total of one hour is allotted for oral argument. Justice Powell and Justice Scalia OUT.
8	Nov 20 1986		***** Brief amicus curiae of Committee on State Taxation filed. VIDEDED.
9	Nov 21 1986		Record filed.
10	Nov 20 1986		Joint appendix filed. VIDEDED.
11	Nov 20 1986		Brief of appellant Tyler Pipe Industries filed.
12	Dec 5 1986	S	Motion of appellants for divided argument filed.
13	Dec 15 1986		Motion of appellants for divided argument GRANTED. Justice Powell OUT.
14	Dec 24 1986		Brief amicus curiae of National Governors' Assoc., et al. filed. VIDEDED.
15	Dec 19 1986		SET FOR ARGUMENT. Monday, March 2, 1987. This case is consolidated with No. 85-2006. (4th case) (1 hour).
16	Dec 24 1986		Brief of appellee WA Dept. of Revenue filed. VIDEDED.
17	Jan 5 1987		CIRCULATED.
18	Feb 11 1987	X	Reply brief of appellant Tyler Pipe Industries filed.
19	Feb 20 1987	X	Joint appendix filed. VIDEDED.
20	Feb 20 1987		* Volume II
21	Mar 2 1987		ARGUED.

EDITOR'S NOTE

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No.

Supreme Court, U.S.

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**In The
Supreme Court
Of The United States**

October Term, 1985

TYLER PIPE INDUSTRIES, INC.,

Appellant

vs.

STATE OF WASHINGTON DEPARTMENT OF REVENUE,

Appellee

**On Appeal from the
Supreme Court of Washington**

JURISDICTIONAL STATEMENT

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STATE OF WASHINGTON DEPARTMENT OF REVENUE,

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JURISDICTIONAL STATEMENT

QUESTIONS PRESENTED

Sections 82.04.220 *et seq.*, of the Revised Code of the State of Washington, impose a business and occupation tax upon persons engaged in, *inter alia*, wholesaling and manufacturing, measured by gross receipts received from the activity. Section 82.04.440 of the Revised Code provides an exemption from the manufacturing tax for persons engaged in both manufacturing and wholesaling within the State of Washington.

The questions presented are:

1. Whether the Washington Supreme Court disregarded the standards enunciated by this Court in *Armco, Inc. v. Hardesty*, U.S. , 104 S.Ct. 2620, *rehearing denied*, U.S. , 105 S.Ct. 285 (1984) and *Maryland v. Louisiana*, 451 U.S. 725 (1981) in deciding the case below?
2. Whether the Washington statutory scheme violates the Commerce Clause of the United States Constitution because the tax imposed discriminates against interstate commerce?
3. Whether the Washington statutory scheme violates the Commerce Clause of the United States Constitution because the tax imposed is not fairly apportioned, or is not fairly related to the services provided by the State of Washington?
4. Whether, as applied to Appellant, the tax imposed by these statutory provisions violates the Due Process Clause or the Commerce Clause of the United States Constitution because Appellant's connections with the State of Washington are insufficient to satisfy constitutional standards with respect to nexus?

LIST OF PARTIES

The names of all parties to the proceedings below are reflected in the caption of the case. Pursuant to Supreme Court Rule 28.1, the Appellant, Tyler Pipe Industries, Inc., a Delaware corporation with its principal office in Tyler, Texas, states that it is a wholly-owned subsidiary of Tyler Corporation. There are no other parent corporations, subsidiaries or affiliates of Appellant or Tyler Corporation other than wholly-owned subsidiaries of each.

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Tyler Pipe Industries, Inc., the Appellant, appeals from the final judgment of the Supreme Court of Washington rendered in this case on March 6, 1986. This jurisdictional statement is submitted to show that the Court has jurisdiction of the appeal and that substantial questions are presented.

OPINIONS BELOW

The opinion of the Supreme Court of the State of Washington (Appendix A, *infra*, p. A-1) is reported at 105 Wn.2d 318 and 715 P.2d 123. The opinion of the Superior Court for Thurston County, Washington (Appendix B, *infra*, p. B-1) is not officially reported. The determination and final determination of the State of Washington Department of Revenue (Appendix C, *infra*, p. C-1) are not officially reported. The opinion of the Supreme Court of the State of Washington in the companion case of *National Can Corporation v. The State of Washington* (Appendix D, *infra*, p. D-1) is reported at 105 Wn.2d 327 and 715 P.2d 128.

JURISDICTION

Appellant brought this action in the Superior Court of Thurston County, Washington, seeking a refund of business and occupation taxes imposed by the State of Washington. The Supreme Court of Washington entered and filed its opinion and judgment on March 6, 1986. Appellant filed a notice of appeal in that court on April 15, 1986. Jurisdiction of this Court is invoked under 28 U.S.C. Section 1257(2). Alternatively, the jurisdiction of this Court is invoked under 28 U.S.C. Section 1257(3). *See*, 28 U.S.C. Section 2103.

CONSTITUTIONAL PROVISIONS AND STATUTES

The relevant provisions of the United States Constitution, Article I, Section 8, clause 3; of the United States Constitution, Amendment XIV, Section 1; of 15 U.S.C. Section 381; and of the

Revised Code of Washington, Sections 82.04.220, 82.04.230, 82.04.240, 82.04.250, 82.04.270, 82.04.290, 82.04.440 and 82.04.500 are set forth at Appendix G, *infra*.

STATEMENT OF THE CASE

1. Proceedings Below; Federal Question Raised

The Department of Revenue for the State of Washington assessed business and occupation taxes (hereinafter referred to as "B&O taxes") for the period January 1, 1976 through September 30, 1980 against Appellant, Tyler Pipe Industries, Inc. Appellant petitioned the Department of Revenue for correction of the assessment on the grounds that imposition of the tax against Appellant violated a federal statute and the U.S. Constitution. The Department denied the petition. Appellant then sought a temporary injunction in the Superior Court for Thurston County, Washington, against the Department's collection of the assessment. In its complaint, Appellant asserted that the assessment violated the Due Process and Commerce Clauses of the United States Constitution and the Federal Interstate Income Tax Act, 15 U.S.C. Sections 381 *et seq.* The Superior Court granted the injunction on June 8, 1981. The grant of the injunction was reversed by the Supreme Court of the State of Washington on January 4, 1982 on the grounds, *inter alia*, that Appellant was not likely to succeed on the merits of its constitutional claims.

Appellant paid the tax assessment on March 10, 1982 and sued for refund in the Superior Court for Thurston County, State of Washington, on the grounds that assessment and collection of the tax violated the Due Process and Commerce Clauses of the United States Constitution and the Federal Interstate Income Tax Act. The Superior Court filed a memorandum opinion dated June 15, 1984 in which it held that the tax did not violate the Due Process Clause because the tax is fairly apportioned and there was a sufficient nexus between Appellant and the State of Wash-

ington to justify imposition of the tax (Appendix B, *infra*, p. B-4). The latter conclusion was based on activity performed in the state by independent sales representatives. The court also concluded that the tax did not violate the Commerce Clause because the tax treats interstate and intrastate commerce equally and because the tax is fairly related to services provided by the state (Appendix B, *infra*, p. B-6). The court rested these conclusions on the decision of the Washington Supreme Court in *Chicago Bridge and Iron Co. v. Department of Revenue*, 98 Wn.2d 814, 659 P.2d 463 (1983), *appeal dismissed*, 464 U.S. 1013 (1983). Finally, the court found the Federal Interstate Income Tax Act inapplicable to the Washington B&O tax (Appendix B, *infra*, p. B-6). The Superior Court denied Appellant's motion for reconsideration on August 6, 1984, and entered Findings of Fact, Conclusions of Law, and Judgment on October 24, 1984 (Appendix B, *infra*, pp. B-7 to B-15).

Appellant timely filed its Notice of Appeal to the Washington Supreme Court on November 9, 1984, raising as error each of the issues raised and rejected in the Superior Court. The Washington Supreme Court filed its opinion on March 6, 1986, affirming the Superior Court in all respects (Appendix A, *infra*, p. A-1). The court dealt first with the Commerce Clause issue and found, on the basis of its opinion in the companion case of *National Can Corp. v. Department of Revenue*, 105 Wn.2d 327, 715 P.2d 128 (1986) (Appendix D, *infra*, p. D-1), that the B&O tax does not discriminate against interstate commerce. The court then found that there was a sufficient nexus between the State of Washington and activities performed on behalf of the Appellant to satisfy constitutional standards for purposes of the Commerce Clause and the Due Process Clause and also found that the tax was fairly apportioned (Appendix A, *infra*, pp. A-5 to A-9). Finally, the court rejected Appellant's argument regarding the Federal Interstate Income Tax Act concluding that the Washington B&O tax is not a "net income tax" within the meaning of the statute (Appendix A, *infra*, p. A-9).

2. Statement of Facts

Appellant is a corporation established under the laws of the State of Delaware that is qualified to do business in the State of Texas and maintains its principal place of business in Tyler, Texas. It is engaged in the business of selling pipe, plumbing and related products.

Appellant markets nationwide many types of plumbing pipes and fittings manufactured by its wholly-owned subsidiaries, Tyler Pipe Industries of Texas, Inc. ("Tyler-Texas"), Tyler Plastics Company, and others. The taxes for which refund is sought were assessed with respect to the gross receipts from sales by Appellant to Washington customers of products manufactured by the latter two named subsidiaries. Appellant and its subsidiaries are subject to, and pay, substantial franchise and *ad valorem* taxes in the State of Texas, both of which taxes are based in part upon the value of the products and the assets utilized in the production and storage of the products sold to Washington customers. Texas does not currently impose a net income tax or gross receipts tax.

Neither Appellant nor its subsidiaries maintain an office, plant, or any other place of business in the State of Washington. They are not qualified to do business in the State of Washington. They do not have any employees located in or active in the State of Washington, and they have never sent personnel into the State of Washington for the purpose of soliciting or accepting orders from customers. They do not send material or products into the State of Washington except by U.S. Mail or independent common carrier. They do not solicit sales in the State of Washington except through instrumentalities of interstate commerce, such as the telephone, advertisements in national trade magazines and occasional mailings from Tyler, Texas. Neither Appellant nor Tyler-Texas maintains any assets or inventory in the State of Washington. Accordingly, the Department of Revenue's sole basis for asserting taxing jurisdiction in this case is that Appellant's products

are handled in Washington by an independent sales representative, Ashe & Jones, Inc., which is located in Seattle. RP 15-19; RP 20-60.¹

The sales representative acts independently of Appellant and its subsidiaries. It is paid on a commission basis according to the volume of sales of Appellant's products in its respective territories in the states of Washington, Oregon, Idaho, Montana and Alaska and in three Canadian provinces. It is not under the direct supervision or control of Appellant and does not receive any administrative and financial assistance or counseling from Appellant. The sales representative, on its own, solicits sales of Appellant's products, and also handles the plumbing products of various other firms and companies. RP 17; RP 268 *et seq.*

A typical sale is handled in the following manner. A potential customer, usually a wholesale plumbing or similar firm, contacts the sales representative with an order. The sales representative in turn contacts Appellant by telephone and forwards the order. All orders placed by a sales representative are subject to acceptance in Texas by Appellant. The products are shipped directly to the purchasing customer from Tyler, Texas, by common carrier, and the purchasing customer is billed by mailed invoice from Tyler, Texas. The customer pays Appellant directly; the sales representatives do not collect payments. Defective items are occasionally returned to Appellant via independent common carrier. In many cases, Washington customers contact Appellant directly by telephone or through the mail, bypassing the sales representative. In such a case the sales representative is not involved in the ordering process, and shipment and payment remain the same. RP 33 *et seq.*; RP 185 *et seq.*

¹RP references are to the Report of Proceedings transcribed from the trial and made a part of the record on appeal in the Washington Supreme Court.

The market involved is primarily a national one. The advertising and the contacts usually made are on a national level. Although the independent sales representative does keep track of and advise on local market conditions, its activities are not necessary to enable Appellant to sell to Washington customers. RP 46 *et seq.*, RP 195 *et seq.*, RP 287.

During the audit period, neither Appellant nor its subsidiaries, sent any service personnel into the State of Washington. Thus, Appellant's only connection with the State of Washington was through the use of means of interstate commerce (i.e. telephone, mail and independent common carriers) and through the sales representative, who was independent of Appellant, handled the products of other companies, and was not involved in approximately 33% of the sales during the audit period. RP 17, 18, 19, 37, 38, 45, 268 *et seq.*

The State of Washington imposes the Washington B&O tax at the rate of .44% on gross receipts from the sale of products in the state. The state imposes the tax on the seller, not the buyer, of the items. The tax is described as a tax on the privilege of doing business in the state. R.C.W. Sections 82.04.220, 82.04.270, and 82.04.500. The tax is imposed separately on various activities performed within the state, including manufacturing and wholesaling. R.C.W. Sections 82.04.240 and 82.04.270. The taxes in issue in this case are entirely wholesaling taxes as Appellant performs no other taxable activities in the state. *Section 82.04.440 of the Revised Code of Washington provides an exemption from the manufacturing tax for taxpayers engaged in both manufacturing and wholesaling within the state who pay the wholesaling tax on products manufactured and then sold within the state. Therefore, despite the fact that the tax is imposed separately on each activity, the State of Washington imposes the same tax on persons who manufacture outside the state and wholesale within the state as it imposes on persons who both manufacture and wholesale within the state.*

THE QUESTIONS ARE SUBSTANTIAL

The Washington Supreme Court erred grievously in deciding the case below. Despite the fact that two recent decisions of this Court, *Armco, Inc. v. Hardesty*, U.S. , 104 S.Ct. 2620, *rehearing denied*, U.S. , 105 S.Ct. 285 (1984) and *Maryland v. Louisiana*, 451 U.S. 725 (1981), set forth clear standards for assessing the constitutionality of a state taxing scheme that are applicable to the Washington B&O tax, the court below disregarded these standards. Instead, the court attempted to distinguish *Armco* and *Maryland* and reverted to earlier precedent of this Court and of the Washington Supreme Court to support its decision. *Armco* and *Maryland* have cast serious doubt on, if they have not in fact overruled, prior decisions involving the Washington B&O tax and raise substantial questions requiring plenary consideration by this Court of the issues raised below.

I.

THE WASHINGTON B&O TAX DISCRIMINATES AGAINST INTERSTATE COMMERCE.

The starting point of any analysis of a state tax is the decision in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, *rehearing denied*, 430 U.S. 976 (1977). There the Court stated that, in order to satisfy the constitutional requirements of the Commerce Clause (U.S. Constitution, Article I, Section 8, clause 3), a state tax must be applied to an activity with a substantial nexus with the taxing state, be fairly apportioned, not discriminate against interstate commerce, and be fairly related to the services provided by the state. Similarly, the Due Process Clause of the Fourteenth Amendment (U.S. Constitution, Amendment XIV, Section 1) requires that, for a state tax to be enforceable in interstate commerce, there be a minimal connection between the interstate activities of the taxpayer and the taxing state and a rational relationship between the income attributed to the state and the intra-

state value of the enterprise. *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 436-437 (1980).

This Court has discussed the non-discrimination requirement in numerous cases and has held that any tax which by its terms or operation imposes greater burdens on out of state goods or activities than on competing in-state goods or activities must be struck down as discriminatory under the Commerce Clause. W. Hellerstein, "Constitutional Limitations on State Tax Exportation," 1982 *American Bar Fdn. Research J.* 1, 22 (1982). States are prohibited by the Commerce Clause from (1) granting a direct commercial advantage to local business under their taxing schemes, *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 328 (1977); *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959); *Maryland v. Louisiana*, *supra*; or (2) subjecting interstate commerce to the risk of multiple tax burdens to which local commerce is not exposed, *Northwestern States Portland Cement Co. v. Minnesota*, *supra*; *Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434 (1939).

The Washington statutory scheme unconstitutionally discriminates against out-of-state manufacturers such as Appellant who sell their products in Washington. Washington's B&O tax is imposed upon extraction of natural resources, manufacturing, retailing and wholesaling, at the rate of 0.44% on the value of products or the gross proceeds of sale. RCW 82.04.230, 82.04.240, 82.04.250, 82.04.270. A tax is imposed at the rate of 1% on the gross proceeds from service and other business activities. RCW 82.04.290. A Washington taxpayer who pays the tax on retailing or wholesaling is exempt from taxation of in-state manufacturing and extracting activities with respect to the items sold, and a Washington taxpayer who pays a manufacturing tax is exempt from taxation of in-state extraction activities with respect to the manufactured items. RCW 82.04.440. The effect of the Washington statute is to subject a Washington business to taxation only once on all of its extraction, manufacturing and whole-

sale or retail marketing activities, but to subject interstate business to double or triple taxation: full taxation in each separate state in which the out-of-state company conducts its extraction, its manufacturing or its wholesale or retail marketing activities.

The Washington B&O tax is at least as discriminatory as the taxing schemes held unconstitutional in *Armco, Inc. v. Hardesty*, *supra*, and *Maryland v. Louisiana*, *supra*. In *Armco*, an 8-1 majority of the Court held that the West Virginia wholesale gross receipts tax unconstitutionally discriminated against interstate commerce. Under the West Virginia tax scheme, a tax of 0.27% was imposed on wholesaling and a tax of 0.88% was imposed on manufacturing. West Virginia manufacturers paid only the manufacturing tax; they were exempted from the wholesaling tax. As a result, a company manufacturing and selling within West Virginia was subject to only one tax, whereas an out-of-state manufacturer was potentially subject to a tax on manufacturing in its home state and on wholesaling in West Virginia. The Court held that this taxing scheme discriminated against interstate commerce on its face and thus was invalid under the Commerce Clause.

The Washington B&O tax imposes the same rate of tax (.44%) on manufacturing and wholesaling activities, RCW 82.04.240 and RCW 82.04.270, but exempts from taxation the activities of in-state manufacturers with respect to items sold within the state. RCW 82.04.440. As a result, a company manufacturing and selling within Washington is subject to only one tax, and a company manufacturing out-of-state and selling within Washington is potentially subject to a tax in its home state on manufacturing and in Washington on selling. The Washington Supreme Court refused to apply *Armco* to invalidate the Washington B&O tax. *National Can Corp., supra*, 715 P.2d at 131-135 (Appendix D, *infra*, pp. D-6 to D-13). Instead, the court purported to distinguish *Armco* on the ground that the Washington tax is not "facially discriminatory" and that the Washington taxes on manufac-

ing and wholesaling are complementary and therefore compensatory. There is absolutely no rational basis for those conclusions, and the "distinction" between *Armco* and the instant case utterly fails to withstand scrutiny.

In a dissenting opinion in *General Motors Corporation v. Washington*, 377 U.S. 436, 451 (1964), which dissent was cited favorably in *Armco, supra*, U.S. at , 104 S.Ct. at 2623, Justice Goldberg discussed the difference between a tax scheme that grants a manufacturer an exemption from a wholesaling tax and one which grants a wholesaler an exemption from a manufacturing tax and stated that the latter "provision would seem to have essentially the same economic effect on interstate sales, but has the advantage of appearing nondiscriminatory." *General Motors Corporation v. Washington, supra*, 377 U.S. at 460. Justice Goldberg added that the resulting threat of multiple taxation to an out-of-state manufacturer would place him in a competitive disadvantage relative to an in-state manufacturer, resulting in a violation of the Commerce Clause. That the Washington B&O tax was the subject of his discussion is particularly noteworthy.

The Court's decision in *Maryland v. Louisiana, supra*, further undermines the conclusion of the court below that the Washington tax is not facially discriminatory. In *Maryland* the Court held that a "state tax must be assessed in light of its actual effect considered in conjunction with other provisions of a State's tax scheme." *Maryland v. Louisiana, supra*, 451 U.S. at 756. That holding served to invalidate a first use tax imposed by Louisiana on outer continental shelf gas brought into Louisiana for processing. The tax discriminated in favor of Louisiana residents because residents were granted credits against other state taxes for any payment of the first use tax on gas consumed in Louisiana while the first use tax was imposed without credits on any gas transported out of Louisiana after processing. The Court found that this scheme unquestionably discriminated against interstate commerce. Similary, the Washington B&O tax, which purports to

treat all wholesalers equally by imposing a tax on gross receipts at the same rate for in-state and out-of-state manufacturers who sell in Washington, unquestionably discriminates against out-of-state manufacturers. The tax scheme accomplishes this by exempting in-state manufacturers from the manufacturing tax for items both manufactured and sold in Washington while out-of-state manufacturers are potentially subject to both a manufacturing tax in their state of manufacture and the Washington wholesaling tax.

The distinction observed by the Washington Supreme Court with respect to the manufacturing and wholesaling taxes being compensatory is even more suspect. The compensating tax issue was raised by the West Virginia Supreme Court of Appeals in *Armco* to justify the wholesaling exemption for West Virginia manufacturers since such manufacturers were subject to a higher tax than out-of-state manufacturers selling in West Virginia. This Court rejected that proposition because there was no basis for apportioning the higher manufacturing tax between manufacturing and wholesaling and because the manufacturing tax was not reduced for those companies that wholesale outside West Virginia. In this case, the wholesaling tax is the same for in-state and out-of-state manufacturers. Therefore, it is logically inconsistent to state that part of the wholesale tax is to compensate the state for the manufacturing tax which would otherwise be due from in-state manufacturers. Moreover, just as there was no reduction in the West Virginia manufacturing tax when wholesaling was done elsewhere, there is no reduction in the Washington wholesaling tax when manufacturing is done elsewhere. It is impossible to maintain that part of the wholesaling tax is in compensation for the exempted manufacturing tax. The Court in *Armco* also refused to consider manufacturing and wholesaling as "substantially equivalent events" such that the taxes on the two activities could be considered compensating as would, for instance, a sales tax and a use tax. There is absolutely no distinction on this score between *Armco* and the case at bar.

Furthermore, the Washington Supreme Court refused to apply the "internal consistency" rule of *Armco* that requires a court to determine the constitutionality of a tax based on the premise that the tax is imposed by every jurisdiction. Despite the fact that this Court rejected the contention that actual proof of discriminatory impact is required in order to find a tax invalid under the Commerce Clause, the court below stated that such proof will be required unless it could be shown that the tax in question was "facially discriminatory." While the internal consistency concept originated in the fair apportionment analysis of a multi-state net income tax case, this Court used the concept in *Armco* to invalidate a gross receipts tax and is applicable here. *Armco* did not require a *showing* of facial discrimination before applying the internal consistency rule, but merely an *allegation* of it. A court must make its determination of whether a tax discriminates on its face by assuming the tax is imposed in all states.

II.

THE WASHINGTON B&O TAX IS NOT FAIRLY APPORTIONED AND IS NOT FAIRLY RELATED TO SERVICES PROVIDED BY THE STATE.

In dealing with the fair apportionment and fairly related standards of the *Complete Auto* test, the court below similarly rejected controlling precedent of this Court. Apportionment is necessary to ensure that only income from intrastate activities is subjected to tax. While most apportionment questions have arisen in the context of state income taxes, the apportionment question is also significant in gross receipts tax cases, which present as great a danger of interference with interstate commerce because, as in this case, the total sales price of an item is subjected to tax despite the fact that a substantial part of the activity that resulted in that sale occurs outside the taxing jurisdiction. See the dissenting opinion of Justice Brennan in *General Motors Corp. v. Washington*, *supra*, 377 U.S. at 449-451. If each state in which activity re-

sulting in a sale occurred imposed a tax similar to the Washington B&O tax, the same gross receipts would be taxed two, three or more times. This Court's decision in *Armco* requires that a tax be fairly apportioned to reflect the business conducted in the state and requires the apportionment test to be conducted under the internal consistency concept. Based on the evidence presented below, the Washington B&O tax results in a tax out of all proportion to the business transacted by Appellant in the State of Washington because the greater portion of Appellant's gross receipts from sales in Washington results from activity in Texas rather than in Washington. Despite this fact, the Washington Supreme Court refused to apply the internal consistency test in determining whether the B&O tax is fairly apportioned.

The refusal of the court below to apply this Court's decision in *Armco, Inc. v. Hardesty*, *supra*, on substantial questions interpreting the United States Constitution calls for this Court to exercise plenary jurisdiction over this appeal.

III.

AS APPLIED TO APPELLANT, THE WASHINGTON B&O TAX IS UNCONSTITUTIONAL BECAUSE A SUFFICIENT NEXUS DOES NOT EXIST BETWEEN APPELLANT'S ACTIVITIES AND THE STATE.

The Washington Supreme Court also misconstrued this Court's decisions regarding whether or not a sufficient nexus between the State of Washington and Appellant's interstate activities exists. In holding that there were sufficient connections to impose the tax, the court below relied on the decisions in *Standard Pressed Steel Company v. Washington Department of Revenue*, 419 U.S. 560 (1975) and *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960). Initially, it should be pointed out that *Scripto* involved the imposition of a use tax on an out-of-state seller, whereas the tax in question here is a gross receipts tax. This Court stated

in *Norton Company v. Department of Revenue of the State of Illinois*, 340 U.S. 534, 537 (1951), that cases involving use taxes are not controlling where the issue relates to a gross receipts tax because the presence of some local incident bringing the transaction within the taxing power of the state is more easily shown for a use tax. Thus, the activities performed in *Scripto* would not necessarily satisfy the nexus requirements for a gross receipts tax.

Although *Standard Pressed Steel* involved the same gross receipts tax that is at issue here, Appellant demonstrated at trial that the activities allegedly creating the required nexus were not of the same degree as those performed in *Standard Pressed Steel*, but were more similar to the activities performed in *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), *Norton Company v. Department of Revenue*, *supra*, and *McLeod v. J. E. Dilworth Company*, 322 U.S. 327 (1944). In *Standard Pressed Steel* the out-of-state manufacturer maintained a full-time salaried employee in the State of Washington whose duty it was to consult with a single important customer regarding its anticipated needs and requirements, encourage the purchase of products, design and test new products, and resolve product difficulties. The employee, an engineer, was assisted by a group of engineers who visited the customer from taxpayer's home office about every six weeks. In stark contrast to these activities, Appellant's only connections with the State of Washington were through interstate communications and transportation and through an independent sales representative. Appellant had no employees, inventory, manufacturing plants, sales offices, warehouses or property in the State of Washington. Its sales representative handled the products of many different companies, was not involved in substantial in-state solicitation and promotional activities and was not involved at all in many sales.² The courts

²Congress has specifically stated that this type of activity does not constitute the minimum connections necessary to subject a person to the taxing jurisdiction of a state for purposes of a net income tax. Federal

(Footnote continued on next page)

below, ignoring uncontradicted testimony that it was not necessary to utilize an independent sales representative either to make customers aware of Appellant's products or to make sales in the State of Washington, found that the activities of the sales representative constituted a sufficient connection between Appellant and the State of Washington to bring Appellant within the state's taxing power.

Additionally, the lower courts disregarded the uncontradicted evidence that fully one-third of Appellant's sales that were subjected to tax—sales of the utilities division—occurred with no participation whatsoever by the independent sales representative. According to this Court's holding in *Norton Company v. Department of Revenue*, *supra*, the utilities division sales are not taxable even if the activities of the sales representative created the required nexus to justify imposing the tax on sales handled by the representative. In *Norton* a Massachusetts-based company was taxed on all its sales in Illinois based on the presence in Chicago of a branch office and warehouse that made local sales. The company also made other sales in Illinois directly from its home office in Massachusetts. The Court found that, despite the company's own presence in the state—not just through an independent sales representative—Illinois could not tax the company on sales made directly from Massachusetts in which the Chicago office had no participation. Appellant urges that *Norton* supports a finding that none of Appellant's sales in Washington were taxable since Appellant had no presence in the state; however, at the very least, *Norton* requires that Appellant's utilities division sales are not

(Footnote continued from preceding page)

Interstate Income Tax Act, 15 U.S.C. Sections 381 *et seq.* Although this case involves a gross receipts tax, Congress' codification of minimal standards was spurred by its concern over the constitutional relationship between interstate commerce and the taxing power of individual states. Therefore, even if the Federal Interstate Income Tax Act is not applicable to a gross receipts tax, the standards set forth therein should be applicable under a constitutional analysis where the tax involved imposes as great a burden in interstate commerce as would a net income tax.

subject to the tax. The courts below refused to apply *Norton* and erroneously held that all sales were taxable.

Because of these unsupported and clearly erroneous findings, this Court must exercise its "power to examine the whole record to arrive at an independent judgment as to whether constitutional rights have been invaded. . ." *Norton Company v. Department of Revenue, supra*, 340 U.S. at 538. This power constitutes a separate basis for exercising plenary jurisdiction, separate and apart from the questions raised above relating to the decision in *Armco*.

CONCLUSION

For the foregoing reasons, the Court should note probable jurisdiction of this appeal.

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IN THE SUPREME COURT OF THE STATE OF WASHINGTON

TYLER PIPE INDUSTRIES, INC.,
 a Delaware corporation,

Appellant,

v.

STATE OF WASHINGTON,
 DEPARTMENT OF REVENUE,

Respondent.

51110-1
 En Banc

DOLLIVER, C.J.—Tyler Pipe Industries, Inc. (Tyler Pipe) challenges a trial court ruling which upheld the constitutionality of Washington's business and occupation (B & O) tax against Tyler Pipe's commerce clause challenge. The trial court denied Tyler Pipe's request for a tax refund holding that the State had sufficient nexus to tax Tyler Pipe and that the federal interstate income tax act, 15 U.S.C. § 381 (1982), was inapplicable to Washington's B & O tax. We affirm the trial court.

The Washington Department of Revenue assessed B & O taxes against Tyler Pipe in the approximate amount of \$130,000 for its wholesaling activities in Washington. The tax, assessed pursuant to RCW 82.04.220 and .270, is on gross receipts from sales to Washington customers between January 1, 1976 and September 30, 1980 (the audit period).

Tyler Pipe obtained a preliminary injunction against collection of this tax which we reversed in *Tyler Pipe Indus., Inc. v. Department of Rev.*, 96 Wn.2d 785, 638 P.2d 1213 (1982). Tyler Pipe subsequently paid the taxes and filed this action for a refund. The trial court issued its memorandum opinion on June 15, 1984, denying Tyler Pipe's claim to a tax refund. A subsequent motion

for reconsideration was denied. On August 4, 1985, we accepted this case for review as a companion case with *National Can Corp. v. Department of Rev.*, Wn.2d , P.2d (1986).

I

The facts, which were detailed by the trial court and for which there is substantial evidence (*Thorndike v. Hesperian Orchards, Inc.*, 54 Wn.2d 570, 343 P.2d 183 (1959)), are as follows:

Tyler Pipe is a Delaware corporation with its principal place of business in Tyler, Texas. Tyler Pipe markets, sells, and distributes cast iron, pressure and plastic pipe and fittings, and drainage products nationwide. Tyler Pipe owns several subsidiaries which manufacture and sell pipe and plumbing products. Tyler-Texas and Tyler Plastics are wholly-owned subsidiaries of Tyler Pipe. These two corporations manufacture the products sold by Tyler Pipe to Washington customers. All products sold in Washington are manufactured outside the state.

Tyler Pipe is organized into 4 divisions: marketing, purchasing and distribution, finance, and industrial relations. The marketing division consists of the drainage, waste, vent (DWV) sales department and the utility sales department. Tyler Pipe markets its products through these two departments. Most of Tyler Pipe's customers are wholesale distributors. In Washington, both departments use the same sales representative, Ashe and Jones, Inc. of Seattle.

The DWV sales department includes a cast iron DWV sales manager, three regional sales managers, and a Wade, Inc. (Wade) sales manager. Wade is a wholly-owned subsidiary of Tyler, marketing items auxiliary to a DWV plumbing piping system. Wade shares with Tyler a substantial number of the same officers and employees. Wade has its own Washington sales representative, Mechanical Agents, Inc. (MA) of Seattle, which main-

tains an inventory of Wade products (owned by Wade in MA's warehouse in Seattle).

Tyler's regional sales manager, Warren VanDerbeck, is responsible for all DWV (including Wade) sales in a region including Washington state. Tyler Pipe's sales representative for Washington state, Ashe and Jones, Inc., is a Washington corporation and handles all sales functions pertaining to its products in this state; however, both Tyler Pipe and Wade are represented in certain southern Washington counties by Bridgeport Sales, Ltd. of Portland, Oregon. For every sale made in Washington, a commission is paid to the appropriate sales representative even if the customer directly contacts Tyler Pipe or its subsidiaries about the sale.

Virtually all information received by Tyler Pipe, or any subsidiary, regarding the Washington market for Tyler Pipe products is communicated from the sales representatives. This information is necessary to keep Tyler Pipe competitive in the marketplace. The sales representatives regularly act on behalf of Tyler Pipe. In addition to their solicitations, the sales representatives handle approximately two-thirds of the orders to Tyler Pipe from Washington customers.

Tyler Pipe's Washington sales representatives perform any local activities necessary for maintenance of Tyler Pipe's market and protection of its interests because Tyler has no personnel designated as employees residing in Washington. The sales representatives are involved in all Tyler Pipe Washington sales transactions either actively or available to assist, if necessary. The sales functions of these representatives are essentially identical to those of the factory salesmen who represent Tyler in certain other parts of the country.

Neither Tyler Pipe nor any subsidiary paid to any other state any tax measured in whole or in part by sales in Washington, or

income resulting from those sales, during the audit period. Neither Tyler Pipe nor any subsidiary paid any real or personal property taxes in Washington during or for the audit period.

II

The first issue is whether Washington's B & O tax discriminates against interstate commerce thereby violating the commerce clause of the United States Constitution. The four requirements for a valid state tax on interstate commerce under the commerce clause are as follows: (1) there must be a sufficient connection or nexus between the interstate activities and the taxing state; (2) the tax must be fairly apportioned; (3) the tax must not discriminate against interstate commerce; and (4) the tax must be fairly related to the services provided by the state. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 51 L. Ed. 2d 326, 97 S. Ct. 1076, *reh'g denied*, 430 U.S. 976 (1977). *Accord, Chicago Bridge & Iron Co. v. Department of Rev.*, 98 Wn.2d 814, 659 P.2d 463 (1983). The key factor in determining the constitutionality of Washington's B & O tax focuses on whether the tax discriminates against interstate commerce. As we held in the companion case of *National Can Corp. v. Department of Rev.*, Wn.2d ., P.2d (1986), Washington's B & O tax does not discriminate against interstate commerce and the recent United States Supreme Court case of *Armco Inc. v. Hardesty*, U.S. , 81 L. Ed. 2d 540, 104 S. Ct. 2620, *reh'g denied*, U.S. , 83 L. Ed. 2d 222, 105 S. Ct. 285 (1984) is distinguishable.

III

The key issue in this case and the basis of Tyler Pipe's challenge is whether its connections with the State of Washington were sufficient to satisfy constitutional standards for imposition of Washington's B & O tax under the due process and commerce clauses of the United States Constitution. Due process and com-

merce clause arguments are closely related, especially concerning the nexus issue, and will be considered together. *Chicago Bridge & Iron Co. v. Department of Rev.*, *supra* at 819.

The United States Supreme Court has held the due process clause of the Fourteenth Amendment imposes two requirements on a state before it can tax income generated in interstate commerce: (1) some minimal connection or "nexus" between the interstate activities and the taxing state and (2) a rational relation between the income attributed to the state and the intrastate value of the enterprise. *Mobil Oil Corp. v. Comm'r*, 445 U.S. 425, 436-37, 63 L. Ed. 2d 510, 100 S. Ct. 1223 (1980); *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 57 L. Ed. 2d 197, 98 S. Ct. 2340 (1978).

The Department of Revenue has stated the requisite minimal connection or "nexus" in WAC 458-20-193B. See RCW 82.32.300. Under 193B, the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales.

This functional approach is in accord with *Standard Pressed Steel Co. v. Department of Rev.*, 419 U.S. 560, 42 L. Ed. 2d 719, 95 S. Ct. 706 (1975). In *Standard Pressed Steel*, the United States Supreme Court found a sufficient nexus for gross receipts tax where an out-of-state corporation had only one in-state employee. This employee had the responsibility of maintaining a relationship with the corporation's primary customer. No sales or orders were taken by the employee. The employee, however, regularly consulted with the customer regarding its needs for the manufactured product. The Supreme Court based its decision on the employee's activities which "made possible the realization and continuance of valuable contractual relations between" the corporation and its primary customer. *Standard Pressed Steel Co.*, at 562.

While not denying the activities of Tyler Pipe's sales representatives within this state helped it to establish and maintain its

Washington customers, Tyler Pipe claims that because these sales representatives are independent contractors, their activities should not be considered under a due process "nexus" test.

The United States Supreme Court has indicated the characterization of an in-state sales representative as an "independent contractor" is without constitutional significance with regard to the nexus issue. *Scripto, Inc. v. Carson*, 362 U.S. 207, 4 L. Ed. 2d 660, 80 S. Ct. 619 (1960). In *Scripto*, the Court determined that allowing the characterization of the taxpayer's in-state agent as an independent contractor to be a determining factor in whether a company would be taxed "would open the gates to a stampede of tax avoidance." *Scripto*, at 211. The test for nexus, the Court went on to say, should be simply the nature and extent of the agent's activities. *Scripto*, at 211. Cf. *Princess House, Inc. v. Department of Rev., State Bd. of Tax Appeals* order 18818 (Mar. 24, 1980) ("substantial nexus" found where out-of-state taxpayer was represented within the state by an independent manufacturer's representative paid on a commission basis).

The trial court's findings of fact, supported by substantial evidence in the record, reveal ample activities by the in-state sales representative which helped Tyler Pipe establish and maintain its market in this state. This is true even if its Washington based subsidiary (Wade) is not considered. Tyler Pipe challenges a number of the trial court's findings and conclusions concerning this issue. Tyler Pipe's challenges are without merit. Reviewing the entire record before us, we find substantial evidence to support each fact and conclusion entered by the trial court. See *Goodman v. Darden, Doman & Stafford Assocs.*, 100 Wn.2d 476, 670 P.2d 648 (1983). See also *Ridgeview Properties v. Starbuck*, 96 Wn.2d 716, 719, 638 P.2d 1231 (1982) (substantial evidence is evidence in sufficient quantum to persuade a reasonable person of the truth of the declared premise).

The sales representatives acted daily on behalf of Tyler Pipe in calling on its customers and soliciting orders. They have long-

established and valuable relationships with Tyler Pipe's customers. Through sales contacts, the representatives maintain and improve the name recognition, market share, goodwill, and individual customer relations of Tyler Pipe.

Tyler Pipe sells in a very competitive market in Washington. The sales representatives provide Tyler Pipe with virtually all their information regarding the Washington market, including: product performance; competing products; pricing, market conditions and trends; existing and upcoming construction products; customer financial liability; and other critical information of a local nature concerning Tyler Pipe's Washington market. The sales representatives in Washington have helped Tyler Pipe and have a special relationship to that corporation. The activities of Tyler Pipe's agents in Washington have been substantial.

The second prong under the due process test (and the second prong in the commerce clause analysis in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 51 L. Ed. 2d 326, 97 S. Ct. 1076, *reh'g denied*, 430 U.S. 976 (1977)) requires a rational relationship between the income attributed to the taxing state and the intrastate value of the enterprise. *Mobil Oil Corp. v. Comm'r*, 445 U.S. 425, 437, 63 L. Ed. 2d 510, 100 S. Ct. 1223 (1980). This test is met if the State's taxing formula is not arbitrary and does not tax the taxpayer " 'out of all appropriate proportion to the business transacted . . . in that State,' " *Exxon Corp. v. Department of Rev.*, 447 U.S. 207, 227, 65 L. Ed. 2d 66, 100 S. Ct. 2109 (1980) (quoting *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 135, 75 L. Ed. 879, 51 S. Ct. 385 (1931)). The taxpayer has the burden of proving by clear and cogent evidence that the tax is in fact out of all appropriate proportion to the business transaction. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 274, 57 L. Ed. 2d 197, 98 S. Ct. 2340 (1978). The Supreme Court has refused to impose strict restraints on the State's taxing formula. *Moorman Mfg. Co.*, at 280.

Tyler Pipe cites *Hans Rees' Sons, Inc.* for the proposition that Washington's B & O tax is unconstitutional because it is out of all proportion to its activities in the state. The Court concluded in *Hans Rees' Sons, Inc.* that the State's formula was out of proportion when it produced a tax on approximately 80 percent of the taxpayer's income when only 17 percent of that income actually had its source in the state. *Hans Rees' Sons, Inc.*, at 135.

This case is not applicable. Not only does it deal with an entirely different tax scheme, but Washington's B & O tax does not approach the disparity of proportion found in the tax scheme in the *Hans Rees' Sons, Inc.* case. Also, the Supreme Court previously has upheld Washington's B & O tax on entire gross receipts from sales made by the taxpayer into Washington state. *Standard Pressed Steel Co. v. Department of Rev.*, 419 U.S. 560, 42 L. Ed. 2d 719, 95 S. Ct. 706 (1975). Because the receipts from sales made to other states were not included in the taxpayer's taxable gross receipts, the Court concluded that the tax was "apportioned exactly to the activities taxed . . ." *Standard Pressed Steel Co.*, at 564. See also *Chicago Bridge & Iron Co. v. Department of Rev.*, 98 Wn.2d 814, 830, 659 P.2d 463 (1983) (Washington's B & O tax is inherently proportional to in-state activities). A rational relationship and not a strict, exact formula is all that is necessary under the due process and commerce clauses. *Moorman Mfg. Co.*, at 280.

The State has not attempted to tax any sales transactions other than those involving Washington customers. Tyler Pipe urges that any receipts earned from sales from its utility division or from sales of orders placed directly to it from its Washington customers should be exempted from Washington's B & O tax. In its memorandum opinion, the trial court found no useful distinction between the utility division and the DWV division of Tyler Pipe for the purposes of taxing its sales within this state. This is supported by the findings of fact and the record. We concur with the holding of the trial court that the tax, as levied by the State, was

in proportion to Tyler's in-state activity. We affirm the trial court's finding of sufficient nexus between Tyler Pipe and the State of Washington.

IV

The State raises the issue of Tyler Pipe's standing for the first time on appeal. Standing was not an issue at the trial level. If the issue of standing is not submitted to the trial court, it may not be considered on appeal. *Baker v. Baker*, 91 Wn.2d 482, 484, 588 P.2d 1164 (1979). See RAP 2.5(a). We refuse to review the issue of standing.

Finally, Tyler Pipe raises the issue of whether the federal interstate income tax act, 15 U.S.C. §§ 381, *et seq.* (1982), exempts Tyler Pipe from Washington's B & O tax. This argument is without merit. The federal statute applies only to a "net income tax"; Washington's B & O tax is not a net income tax or a net tax on anything. Rather, "B & O taxes are for the privilege of engaging in business during a certain time frame, measured by applying a rate of tax to some tax base." *Puyallup v. Pacific Northwest Bell Tel. Co.*, 98 Wn.2d 443, 451, 656 P.2d 1035 (1982).

The trial court is affirmed.

WE CONCUR:

IN THE SUPERIOR COURT OF THE
STATE OF WASHINGTON

IN AND FOR THE COUNTY OF THURSTON

TYLER PIPE INDUSTRIES, INC.,
a Delaware corporation,

Plaintiff.

No. 81-2-00731-4

vs.

STATE OF WASHINGTON,
DEPARTMENT OF REVENUE,

Defendant.

MEMORANDUM
OPINION

Plaintiff has urged this court to grant a refund of the B & O tax which it has paid pursuant to RCW 82.04.220 and 270. Plaintiff bases its request on the argument that Washington's B & O tax as applied to the plaintiff here violates the Due Process Clause and the Commerce Clause of the United States Constitution. Furthermore, the plaintiff argues that the Federal Interstate Income Tax Act prohibits applying the Washington B & O tax to Tyler Pipe's sales to Washington customers.

After closely examining the plaintiffs' arguments, this court must conclude that the Washington B & O tax as applied to Tyler Pipe does not violate the Constitution under either a due process challenge or a commerce clause challenge. Nor does the Federal Interstate Income Tax Act prohibit the imposition of this tax on Tyler Pipe.

DUE PROCESS

The Due Process Clause requires first, that there be a minimum connection or "nexus" between the taxing state and the interstate activities of the taxpayer. Relevant to the determination of whether or not the requisite "minimal connection" exists is

whether and to what extent the person taxed has used the services, benefits, and protections provided by the taxing state; that is, "whether the state has given anything for which it can ask return." Secondly, there must exist a rational relationship between the income attributed to the taxing state and the intrastate value of the enterprise.

The requisite "minimal connection" or "nexus" has been elaborated in WAC 458-20-193B. Under Rule 193B, the key factor governing nexus is the functional analysis of whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales.

In agreement with this functional approach adopted by the Washington legislature, the Supreme Court of Washington and the United States Supreme Court have held that the intrastate activity is a taxable "nexus" where it helps to establish and maintain a market for the sale of products in the state. *Standard Pressed Steel v. Department of Revenue*, 419 U.S. 560, 42 L.Ed. 2d 719, 95 S. Ct. 706 (1975).

Following legislative directive and legal precedent, this court must examine the activities of the sales representatives of Tyler Pipe within this state to determine whether or not their activities helped Tyler Pipe to establish and maintain its Washington customers. After thoroughly reviewing these activities, this court finds that the activities of the sales representatives clearly helped Tyler Pipe establish and maintain its market in this state. Nor is there any useful distinction between the Utility Division and the DWV Division of Tyler Pipe for the purposes of taxing its sales within this state.

The sales representatives acted daily on behalf of Tyler Pipe in calling on the trade and soliciting orders. They are the channel for approximately two-thirds of the customer orders to Tyler Pipe.

(Interrogatory #25-2) Through their sales contacts, the representatives have long established relations with Tyler Pipe's customers through which they maintain and improve the name, recognition, market share and goodwill of Tyler Pipe. (Defendant's first Interrogatory; plaintiffs answers: Interrogatory #33, p.27.) Through their relationships in the trade, the representatives are also able to relay customer feedback to Tyler Pipe regarding customers, (See Interrogatory #30-2, p.23), market trends, (see Interrogatory #30-2, p.23), product performance, customer financial reliability (See deposition of James B. Horan, p.13. See also, Representative's Contract with Tyler Pipe,) and other "critical" information of a local nature. The representatives are, in fact, Tyler Pipe's only source of information about Washington market conditions, such conditions being vital to keeping Tyler Pipe competitive within the marketplace. (See 12/8/78 memo to Ashe & Jones from Bob Clendennon of Tyler Pipe. See also Interrogatory #30-2, p.28) To the extent local activities are necessary for maintenance of Tyler's market and protection of its interests, those activities are performed by the representatives since Tyler has no regular employees in the State. Tyler Pipe utilized the sales representatives to persuade local Washington engineers and contractors to specify Tyler products in their projects. (See Interrogatory #30, p.27) Although the Washington representatives are not actively involved in pricing or servicing Tyler's products, they are involved in all the sales transactions in the passive sense of being present, aware of Tyler Pipe's transactions and available to assist if necessary. The sales representatives afford to Tyler's customers the "presence" of Tyler as they stand by at all times to assist the customers, to encourage product sales and to promote generally the good will of Tyler Pipe.

In addition to customer relations, the sales representatives supply Tyler Pipe with vital feedback associated with competitor's product lines in the Washington area, potential new customers, and are the first line evaluators of the financial responsibility of potential new customers. (See representatives' agreement.)

Additionally, the representatives sometimes become involved in handling complaints and occasionally make inquiries for Tyler Pipe regarding late payments. (See Deposition of Jam. B. Horan, p.11) Tyler Pipe's sales representatives in Washington are assisted by Tyler agents by telephone approximately once a month per agent. (See Interrogatory #28, p.25)

Finally, Tyler uses Washington roads and transportation facilities whenever it sells a product for delivery to a Washington customer. Services provided by the state also include police and fire protections, "utility" contracts with local governments, the availability of the courts and numerous other advantages of a civilized society.

As a result of the activities of Tyler Pipe's representatives on behalf of Tyler Pipe and as a result of the benefits made possible to Tyler Pipe arising from these activities, this court finds that a sufficient "nexus" exists between the state of Washington and the activities to legitimately assess the Washington B & O tax on Tyler Pipe's sales to its Washington customers.

The second prong of the two prong test for the due process challenge is that there must exist a "rational relationship between the income attributed to the taxing state and the intrastate value of the enterprise." *Chicago Bridge and Iron Company v. Department of Revenue*, 98 Wn.2d. 814, 659 P.2d 463 (1983), U.S. App. Pndg. (C.B.I.). As stated in C.B.I., "no such tax is assessed against interstate sales to other states. Hence the tax is inherently proportional to in-state activities. C.B.I. p. 830. (emphasis added) The State of Washington has not attempted to tax any other sales transactions *other* than those involving Washington customers. Although the tax may be imprecise, the Constitution requires a rational relationship, not exact precision. C.B.I., p. 830. The tax, as levied by the State, is inherently proportional to Tyler's in-state activity.

COMMERCE CLAUSE

The commerce clause requires the taxing state to meet a four prong test: (1) there must be a sufficient connection or nexus between the interstate activities and the taxing state; (2) the tax must be fairly apportioned; (3) the tax must not discriminate against interstate commerce; and (4) the tax must be fairly related to the services provided by the state. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 278-82, 51 L.Ed. 2d 326, 97 S. Ct. 1076 (1977).

The first and second part of the commerce clause test have already been discussed in the court's analysis of the due process challenge and need not be repeated here. Specifically, there is a sufficient "nexus" based on the activities of Tyler Pipe's sales representatives to justify the Washington B & O tax. Secondly, the tax is based on only Washington sales and is therefore inherently proportional to the State of Washington.

The third prong of the commerce clause test requires that a state tax does not discriminate against interstate commerce. That is not to say that a tax may not impose a burden on interstate commerce for the commerce clause does not shelter interstate commerce from "paying its way." The Supreme Court of Washington has stated in C.B.I., *supra*, at 830:

"A state tax on interstate commerce is not discriminatory unless it affords a 'differential tax treatment of interstate and intrastate commerce.' Washington's tax treats intrastate and interstate businesses equally, making no distinction between them. See RCW 82.04. Both . . . are taxed only once on their gross proceeds, not separately for each transaction as manufacturer, wholesaler, or retailer.

The Washington Supreme Court also rejected the argument that the *risk* of double taxation (i.e., taxation where the product is manufactured and taxation where the product is sold) is sufficient grounds for declaring the tax unconstitutional. C.B.I., *supra*, at

p.831. The commerce clause does not prohibit overlaps in taxation nor does it require exact precision in taxation. Therefore, because the Washington B & O tax is applied equally to intra-state activities as well as to interstate activities, it cannot be found to discriminate against interstate commerce.

The fourth and final consideration under the commerce clause test requires the tax to be fairly related to services provided by the state. Again, the Supreme Court of Washington offers this court guidance in addressing this requirement. In *C.B.I., supra*, that court stated that the fourth requirement is closely connected to the first prong of the commerce clause test, the nexus requirement. "It requires that the measure of the tax be tied to the earnings which the State . . . has made possible." Id. at 832. Clearly, Tyler Pipe benefits from the presence of police and fire protection, the availability of the courts, "utility" contracts with local governments, the use of Washington roads and transportation facilities and numerous other "advantages of a civilized society." Therefore, the activities carried on in the state of Washington by Tyler Pipe's sales representatives benefit Tyler Pipe and the tax being assessed is tied to these benefits and earnings which the State has made possible. As a result of the analysis under the four prong test of *Complete Auto Transit, supra*, this court concludes the Washington B & O tax is constitutionally valid.

FEDERAL INTERSTATE INCOME TAX ACT

The FIITA does not, it seems to this court, apply to the B & O tax which the state has attempted to collect from the taxpayer.

Dated this 15 day of June, 1984, at Olympia, Washington.

CAROL A. FULLER, JUDGE

**IN THE SUPERIOR COURT OF THE
STATE OF WASHINGTON
IN AND FOR THE COUNTY OF THURSTON**

TYLER PIPE INDUSTRIES, INC.,
a Delaware corporation,

Plaintiff.

vs.

**STATE OF WASHINGTON,
DEPARTMENT OF REVENUE,**

Defendant.

No. 81-2-00731-4

**FINDINGS OF
FACT,
CONCLUSIONS
OF LAW, AND
JUDGMENT**

This matter was tried to the Court beginning on November 21, 1983. The plaintiff taxpayer, Tyler Pipe Industries, Inc. [Tyler Pipe or Tyler], was represented by Thomas C. McKinnon of Cartano, Botzer, Larson & Birkholz. The defendant State of Washington Department of Revenue [the department] was represented by the Attorney General, through Assistant Attorney General James R. Tuttle. Closing arguments were continued to December 16, 1983. After certain supplemental briefing requested by the Court, the Court issued its Memorandum Opinion, dated June 15, 1984, denying plaintiff's claim to a tax refund. A subsequent Motion for Reconsideration by plaintiff was denied, following argument thereon, by Memorandum Opinion of the Court dated August 6, 1984.

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The Court has heard and considered the oral testimony of witnesses and the written and oral arguments of counsel. In addition, the Court has reviewed and considered the exhibits admitted at trial and the published depositions of Manley Hendricks, James B. Horan, Glenn H. Jones, Dale Meador, and Warren VanDerbeck, together with the remainder of the record herein. Being now fully informed in the matter, the Court enters the following:

FINDINGS OF FACT

1. Tyler Pipe seeks a refund of "wholesaling" business and occupation taxes it has paid, measured by its sales in Washington State during the period from January 1, 1976 through September 30, 1980 (the audit period), in the total amount (including post-assessment interest) of \$130,010.56, plus statutory interest and costs if any are authorized. No refund of taxes measured by Wade, Inc. sales (see below) is sought. The following findings cover the audit period.

2. Tyler Pipe is incorporated in Delaware, has its principal place of business in Tyler, Texas and is in the business of selling piping, plumbing and related products. Virtually all of the products it sells are manufactured in Tyler, Texas. Its organization consists of four divisions: marketing, purchasing and distribution, finance, and industrial relations. The marketing division, in turn, consists of the DWV (drainage, waste, vent) sales department and the utility sales department.

3. The customers of the DWV sales department generally are wholesale plumbing supply distributors (jobbers), whose own customers in turn are "mechanical" and/or "plumbing" contractors. The customers of the utility sales department generally are wholesale "waterworks" distributors, who in turn sell to "utility" contractors, cities, etc. In Washington, both departments use the same sales representative, Ashe and Jones, Inc. of Seattle.

4. The DWV sales department includes a cast iron—DWV sales manager, a Wade sales manager, and three regional sales managers. Wade Inc., a wholly-owned subsidiary of Tyler, markets items auxiliary to a DWV plumbing piping system. It functions as a subdivision of the DWV Sales Department because of its commonality with the DWV products. Like the rest of the DWV sales department, Wade's customers are plumbing wholesalers. Wade, Inc. shares with Tyler a substantial number of the same officers and employees. Wade has its own Washington sales representative, Mechanical Agents, Inc. (MA) of Seattle, which maintains an inventory of Wade products (owned by Wade) in MA's warehouse in Seattle.

5. Tyler's regional sales manager covering the territory of which Washington state is a part, Warren VanDerbeck, is responsible for all DWV (including Wade) sales. He visits, coordinates with, instructs, and assists both Washington sales representatives, Ashe and Jones and Mechanical Agents.

6. Tyler Pipe's sales representatives for Washington State, Ashe and Jones and Mechanical Agents, are Washington corporations and handle all sales functions pertaining to its products in this state. For every sale made in Washington, a commission is paid to the sales representative in whose territory the customer is located, even if the customer itself directly contacts Tyler Pipe or its subsidiaries about the sale.

7. The sales representatives have long-established and valuable relationships with Tyler Pipe's customers. Through their sales contacts, the representatives maintain and improve the name recognition, market share, goodwill, and individual customer relations of Tyler Pipe.

8. Virtually all information received by Tyler Pipe or any subsidiary, concerning the Washington market for Tyler Pipe products, is communicated orally from the sales representatives.

Such information includes vital feedback about existing and potential new customers, product performance, competing products, pricing, market conditions and trends, existing and upcoming construction projects, customer financial reliability, and other critical information of a local nature concerning Tyler Pipe's Washington market. Such information, provided on a regular, timely basis, is necessary to keeping Tyler Pipe competitive in the marketplace.

9. The sales representatives act regularly on behalf of Tyler Pipe in calling on the trade generally and soliciting specific orders from wholesalers. During the audit period, out of a total of 11,438 orders placed with Tyler (including Wade) for delivery in Washington, 7,628 orders were received and transmitted to Tyler by the Washington sales representatives. Thus, in addition to their solicitations the sales representatives actually physically handle approximately two-thirds of the orders to Tyler Pipe from Washington customers.

10. To the extent local activities are necessary for maintenance of Tyler Pipe's market and protection of its interests, those activities are performed by the sales representatives, since Tyler has no personnel designated as employees residing in Washington. For example, the sales representatives make "secondary calls" to persuade Washington architects and engineers, and plumbing contractors (customers of the wholesale distributors), to specify and use Tyler products in their projects; the representatives also provide price quotations of Tyler Pipe products for specific construction projects. They may be asked by Tyler to make inquiries about specific competing products and to provide counteracting sales information. Sales representatives participate in investigating and handling adjustments for, or complaints from, customers. Finally, the local sales representative may make inquiries for Tyler regarding late payments; although this has not been much of a problem in Washington, it is Tyler's usual practice to involve

the local representative in trying to obtain payment from a slow-paying customer before that account is referred to an outside agency for collection.

11. The sales representatives are involved in *all* Tyler Pipe Washington sales transactions either actively, as set forth above, or at least in the passive sense of being present, aware of the transactions, and available to assist if necessary. The sales representatives afford to Tyler's customers the "presence" of Tyler as they stand by at all times to assist the customers, to encourage product sales, and to promote generally the goodwill of Tyler Pipe.

12. The aforementioned sales functions of Tyler's Washington sales representatives are essentially identical to those of the factory salesmen who represent Tyler in certain other parts of the country. There are no significant differences between these sales representatives and those salespersons with regard to how they solicit and process orders or otherwise "call on the trade," although only the salespersons are designated by Tyler as employees.

13. A typical sales transaction is processed as follows. The local sales representative having received an order, or the customer, calls Tyler and conveys the order to a telephone sales correspondent in the appropriate division. During the audit period, neither Tyler Pipe nor any subsidiary ever rejected an offer or order arranged or transmitted by a Washington sales representative.

14. An invoice is prepared at Tyler on a pre-printed form bearing the name "Tyler Pipe Industries" and the company's logo, with the division name being added by the computer. The invoice form identifies Tyler Pipe Industries, Inc. as the seller, and the same invoice form is used for billing by all divisions. The transaction is basically the same when the sale is made from Wade stock stored in the warehouse of the local sales representative (e.g., Mechanical Agents).

15. Tyler goods are sold F.O.B. destination. Title to the goods passes to the customer at the point of delivery, *i.e.*, in Washington State for the sales in question. Tyler Pipe, as shipper, is responsible for paying freight, delivery, and other shipping costs. Shipments to customers are made, either directly from Tyler's plant in Tyler, Texas via commercial motor freight or, in the case of Wade sales, from Mechanical Agents' Seattle warehouse by commercial carrier. Tyler Pipe's total sales to Washington customers during the audit period consisted of \$24,919,708 thus shipped from Texas and \$787,736 of Wade products thus shipped from the Seattle warehouse. (Minimal amounts of Wade products also were shipped to Washington customers from an out-of-state location during the audit period.)

16. For all sales made by Tyler Pipe or any subsidiary or division, the customer's payment is made directly to Tyler Pipe at the same post office box in Dallas, Texas.

17. Neither Tyler Pipe nor any subsidiary paid to any other state any tax measured in whole or in part by sales in Washington, or income resulting from those sales, during the audit period. Neither Tyler Pipe nor any subsidiary paid any real or personal property taxes in Washington during or for the audit period.

18. Tyler Pipe takes advantage of and uses Washington roads and transportation facilities whenever it sells a product for delivery to a Washington customer. Other benefits provided to Tyler Pipe and its products by the state of Washington include police and fire protections, "utility" construction contracts awarded by local governments which utilize Tyler products, the availability of the courts, and numerous other advantages of a civilized society.

CONCLUSIONS OF LAW

1. This Court has jurisdiction over the subject matter and the parties in this case.

2. The test applied to state taxation of interstate business under the due process clause of the U.S. Constitution is two-pronged: (1) there must be a "minimal connection" or "nexus" between the interstate activities and the taxing state, and (2) the income attributed to the state for tax purposes must be rationally related to "values connected with the taxing state." Both parts of this test are met here.

3. The department has duly promulgated WAC 458-20-193B (Rule 193B) defining the conditions of liability for payment of business and occupation tax by persons selling goods originating in other states to buyers in Washington. That rule is valid.

4. The actions of Tyler Pipe through its representatives in Washington create a sufficient nexus to satisfy the first prong of the due process test, as interpreted in Rule 193B, and thus permit application of the wholesaling business and occupation tax for sales made by Tyler Pipe in Washington. These actions constitute "local activity which is significantly associated with the seller's ability to establish and maintain a market in this state for [its] sales." The representatives' "instate services enable [Tyler Pipe] to make the sales." Orders for the goods sold in Washington are solicited in this state by an agent or other representative of Tyler Pipe, the seller. Moreover, Tyler Pipe's Washington sales representatives perform significant services in Washington which contribute to the establishment and maintenance of the market and otherwise enable Tyler Pipe to make sales within the state. The fact that Tyler designates them as representatives, rather than as employee salesmen, without a difference in function, lacks constitutional significance.

5. The second prong of the due process test is also satisfied here because the sales proceeds, the measure of the tax, are rationally related to values connected with Washington. Since no Washington business and occupation tax is assessed against sales made by Tyler Pipe in other states, the tax imposed on sales in Washington is inherently proportioned to in-state activities.

6. The commerce clause of the U.S. Constitution imposes four requirements for a state tax on interstate commerce: (1) there must be a sufficient connection or nexus between the interstate activities and the taxing state; (2) the tax must be fairly apportioned; (3) the tax must not discriminate against interstate commerce; and (4) the tax must be fairly related to the services provided by the state. Those requirements are met here.

7. The commerce clause nexus requirement in the context of this case is the same as the due process nexus requirement discussed above, Conclusion of Law No. 4, and thus is met here.

8. The Washington business and occupation tax, as imposed on Tyler Pipe's sales in Washington, is fairly apportioned. The tax was assessed upon Tyler Pipe's gross proceeds from Washington sales only, not its total volume of interstate sales. Thus, the tax was and is apportioned exactly to the activities taxed.

9. The Washington business and occupation tax, as applied to Tyler Pipe, does not discriminate against interstate commerce. Both intrastate and interstate businesses are treated equally. Tyler Pipe, other out-of-state and in-state manufacturers, and other businesses, selling at wholesale in Washington, are subject to wholesaling business and occupation tax at the same rate. Under such circumstances, Tyler Pipe is not discriminated against merely because it can speculate about the "risk" of multiple taxation, when in fact no other state taxes its Washington sales.

10. The Washington business and occupation tax imposed on Tyler Pipe is fairly related to services provided it by the state. Tyler Pipe receives numerous benefits from the state of Washington.

11. The Washington business and occupation tax is not a "net income tax" for purposes of Public Law 86-272, codified as 15 U.S.C. §§ 381 et seq. It is neither an "income" tax nor a "net" income tax, as defined in that statute. Since the effect of Public Law 86-272 is expressly limited to a net income tax, that statute is inapplicable here.

JUDGMENT

On the basis of the foregoing Findings of Fact and Conclusions of Law, IT IS HEREBY ORDERED, ADJUDGED AND DECREED that:

1. The plaintiff's claim to a refund of excise taxes paid is denied and dismissed with prejudice;
2. Judgment is granted to the defendant State of Washington Department of Revenue; and
3. The defendant is awarded its taxable costs herein.

DATED this 24th day of October, 1984.

CAROL A. FULLER
Judge of the Superior Court

Presented by:

KENNETH O. EIKENBERRY
Attorney General

By _____
James R. Tuttle
Assistant Attorney General
Attorneys for Defendant

Approved As To Form:

CARTANO, BOTZER, LARSON & BIRKHOLZ

By _____
Thomas C. McKinnon
Attorneys for Plaintiff

JOHN SPELLMAN
Governor

GLENN R. PASCALL
Director

STATE OF WASHINGTON
DEPARTMENT OF REVENUE
Olympia, Washington 98504 MS-AX-02

March 12, 1981

Cartano, Botzer and Chapman DETERMINATION
1300 IBM Building No. 81-39
Seattle, Washington 98101
Attention: Thomas A. Sterken Re: Tyler Pipe Industries, Inc.
Tax Assessment No. 0719800
Registration No. C600 382 582

Dear Mr. Sterken:

We have thoroughly reviewed your petition of February 25, 1981, on behalf of the above referenced taxpayer. It seeks a correction of Tax Assessment No. 0719800 which was issued in the amount of \$123,159 on December 26, 1980 covering the audit period from January 1, 1976 through September 30, 1980. The assessment represents a tax and interest deficiency under the business and occupation tax classification, Wholesaling-Other, measured by the taxpayer's gross income from its sales of pipe and plumbing fittings to wholesale customers in Washington State. The assessment is unpaid.

The taxpayer protests the tax assessment as being an unconstitutional application of WAC 458-20-193B (Rule 193B) under the facts outlined in the petition, in violation of the Interstate Commerce and Due Process clauses of the Federal Constitution. The petition sets forth, in detail, the taxpayer's legal arguments and the case law supports relied upon.

Our analysis of the petition reveals that no useful purpose would be served the taxpayer or the state of Washington by scheduling a hearing of these matters. The Department of Revenue has fully and uniformly stated its position, under the law, on the precise factual and constitutional questions presented in this case, as set forth below. The Department is committed in litigation to the position that Rule 193B requires payment of the tax under the facts here present. Accordingly, pursuant to WAC 458-20-100(7), the taxpayer's petition is hereby denied.

To put the Department's position in perspective, we will restate here the facts of this case as presented in the taxpayer's petition and undisputed by the auditor.

The only connection which the Company has had with the State of Washington during the tax years in question, as described in detail below, is that *the Company has sold plumbing fittings and pipe to Washington customers*. The products which the Company distributes and sells are actually manufactured by two of the Company's wholly-owned subsidiaries, Wade, Inc. ("Wade"), (a Virginia corporation) and Tyler Pipe Industries of Texas, Inc. ("Tyler Pipe"), (a Texas corporation), both of which maintain their principal offices and places of business in Tyler, Texas. Wade manufactures special order plumbing fittings, while Tyler Pipe manufactures most other types of plumbing pipes and fittings. Neither the Company nor their subsidiaries maintain any employees or offices in the State of Washington nor is any of such companies qualified to do business in the state. *Orders are placed with the Company through the Company's independent sales representatives in the State of Washington*. Ashe & Jones of Seattle represents the Company in part of the state as well as in certain other states and handles Tyler Pipe products, while Mechanical Agents, Inc., also of Seattle, represents the Company in another part of the State of Washington and in certain other states and handles Wade products. Neither the Company, which is the seller, nor Tyler Pipe has any assets or inventory in the

State of Washington. *Wade maintains only a small inventory at Mechanical Agents, Inc.'s Seattle warehouse.*

The Company's sales representatives act independently and receive commissions on sales made to customers in their territory, but their duties are very limited. Neither representative actively solicits business for the Company and both representatives also handle the plumbing products of numerous other firms and companies. The representatives' customers consist primarily of various wholesale plumbing outfits. *The representatives provide service manuals to customers in the State of Washington*, but catalogs and price lists are mailed directly to customers by the Company from Tyler, Texas.

Most, but not all sales to Washington residents are handled through a sales representative. Some orders, however, are placed directly by the customer with the Company. A typical sale made through a representative is handled in this manner. *First, a representative's customer indicates its plumbing needs to a Seattle representative. The representative then either calls the Company in Texas and gets a telephone bid from the Company, or checks the Company's price list, and calls the Company to place an order with a telephone sales correspondent.* Assuming Company approval of the order, the representative sends the Company a confirming purchase order and the Company fills the order. All sales of Tyler Pipe products and most sales of Wade products are shipped by the Company from the Company's facilities in Tyler, Texas to customers in Washington by common carriers. An invoice is prepared to bill the customer after any goods are shipped. The invoices printed at the Company bear the Tyler Pipe/Tyler Corporation logo. For the relatively small portion of sales made from *Wade's inventory stored in Mechanical Agents' Seattle warehouse*, the transaction is basically the same. Mechanical Agents must obtain the approval of the Company before a shipment is made out of such inventory.

Customer's payments are made directly to the Company; its representatives never handle any such payments nor do the representatives assist the Company in any way in collecting any overdue amounts. Full payment is due after delivery to the customer with various cash discounts allowed to encourage prompt payment. The Company has never used the Washington court system to collect any delinquent accounts in Washington, nor availed itself of any other Washington services.

In the event of a customer complaint, *the customer either calls the Company or one of the representatives* who then refers the customer to the Company. The Company has never sent any service personnel to the State of Washington, as all valid complaints are resolved by phone or correspondence with the Company, either by crediting the customer's account or by return and replacement of any defective pipes or fittings. (Emphasis ours.)

It is the firm position of the Department that instate activities of sales representatives precisely such as those underscored in the taxpayer's stipulated presentation above constitute nexus upon which Washington State may constitutionally predicate its taxing jurisdiction over gross sales income here. The Department, the Washington State Board of Tax Appeals, and the Washington Courts have sustained the imposition of this taxing jurisdiction in cases such as this after full consideration of the very case law precedents cited in the taxpayer's petition.

The Superior Court for Thurston County sustained the Department's position on October 2, 1980 in PVO International, Inc. v Department of Revenue, Cause No. 79-2-00732-1. The Court expressly upheld the validity of Rule 193B and held further that,

For the purpose of determining the existence of nexus under the due process and commerce clause of the U.S. Constitution, there is no constitutional significance to be

assigned to the label used to describe the relationships between PVO and Raymer Brand or between PVO and M & S, whether the labels be "employee" or "independent contractor" or "broker". (These were independent brokers who represented PVO and others. PVO had no employees here.) (Parenthetical inclusion ours.)

Representatives' activities, even short of order taking or sales solicitation, conducted in this state on behalf of out-of-state sellers which result in sales to Washington customers constitute nexus for business tax on such sales. This is the import of the Rule 193B statement,

... the following activities are examples of sufficient local nexus for application of the business and occupation tax:

...

- 4 The delivery of the goods is made by a local outlet or from a local *stock of goods* of the seller in this state.
- 5 Where an out-of-state seller, either directly or by an agent or other representative, *performs significant services in relation to establishment and maintenance of sales* into the state, the business tax is applicable, even though (a) the seller may not have formal sales offices in Washington or (b) the agent or representative may not be formally characterized as a "salesman". (Emphasis ours.)

Actual hard sell solicitation is not a criteria or a threshold requirement for a finding of nexus. Rule 193B speaks in terms of "activity . . . significantly associated in any way with the seller's ability to establish and maintain a market" and "significant services in relation to establishment and maintenance of sales into the state". In the General Motors case our State Supreme Court spoke of whether "the tax bore a reasonable relation to . . . activ-

ties within the State" and when that case went on up, the U.S. Supreme Court spoke of whether the "tax is levied on incidents of a substantial local business in Washington", whether the "activities, i.e., the local incidents . . . may be fairly related to those activities", whether there were "substantial services . . . with relation to the establishment and maintenance of sales", and whether the "local activities . . . form some definite link, some minimum connection".

The terms significant, reasonably related, substantial, fairly related, definite link, and minimum connection may not be susceptible of a precise definition for application in every case. Indeed, most out-of-state sellers who do business in Washington through the efforts of brokers, agents, or sales representatives urge the conclusion that the activities engaged in here are minimal, insignificant, insubstantial, and of a mere public relations and goodwill ambassadorial nature. However, we are not persuaded that the acts of providing service manuals and taking and transmitting sales orders for a company which maintains a stock of goods here, however small, are insignificant in establishing and maintaining a sales market here. Surely, to use the kind of language employed by the court in *Standard Pressed Steel Company v Washington*, 419 US 560 (1975) these activities "make possible the realization and continuance of valuable contractual relations"—namely, the sales made thereby. The taxpayer's only business is sales. If the activities of its instate representatives did not stimulate and maintain sales, the taxpayer would not pay commissions. In any event if the taxpayer doubts that the activities of its local representatives significantly affect sales, the taxpayer is always in the position to weigh the rate of commission paid (or total costs to it for services rendered by its independent contractors) against the rate of the Washington business tax (currently .0044) and make the business decision of whether it wishes to have sales related activities performed in its behalf by persons in this state.

Rule 193B is a codification of the collective rationale of numerous U.S. Supreme Court decisions, including *Norton Company v Illinois Department of Revenue*, 340 US 534 (1951); *General Motors v Washington*, 377 US 436 (1964); and *Standard Pressed Steel Company v Washington*, *supra*. We will not here discuss the debatable claimed factual distinctions between the taxpayer's activities and those dealt with in the many cases cited in its petition, including the cases referenced above. As a matter of constitutional principle such factual differences are simply not dispositive of the taxpayer's liability. They have been considered and rejected. See *Princess House, Inc. v State, Board of Tax Appeals Docket No. 18818* (March 24, 1980); *United Grocers, Inc. and Northwest Grocery Company v State, BTA Docket No. 80-6* (November 25, 1980); and *PVO International Co. v Department of Revenue*, *supra*.

Finally, the Department of Revenue, over many years of excise tax administration, has successfully held that 15 USC 381 (commonly referred to as Public Law 86-272) is not applicable to gross receipts taxes, even when challenged by the very arguments raised in the taxpayer's petition. See *Clairol, Inc. v Kingsley*, 270 A2d 702 (1970) dismissed for want of a substantial Federal question, 28 L Ed 2d 643 (1971). The Federal act, by its very terms, applies only to taxes on or measured by net income, and has no effect on excise taxes measured by gross income. Gross receipts taxes, assuming nexus requirements are satisfied, as here, have been permitted for the last 40 years when imposed by the destination state and prohibited when imposed by the state of origin of the goods. Cf. *Hellerstein, State Taxation of Interstate Business and the Supreme Court*, 62 Va Law Review 149 (1976).

For all of the foregoing reasons the taxpayer's petition; on the merits, is hereby denied. Tax Assessment No. 0719800 has accrued mandatory extension interest of \$2,425, for a total of

\$125,584, which is due for payment within twenty days from the date of this Determination.

Very truly yours,

STATE OF WASHINGTON
DEPARTMENT OF REVENUE
INTERPRETATION AND
APPEALS DIVISION

Edward L. Faker, Hearing Officer

cc: Tyler Pipe Industries, Inc.

JOHN SPELLMAN
Governor

GLENN R. PASCALL
Director

STATE OF WASHINGTON
DEPARTMENT OF REVENUE
Olympia, Washington 98504 MS-AX-02

April 30, 1981

Cartano, Botzer and Chapman FINAL DETERMINATION
1300 IBM Building No. 81-39A

Seattle, Washington 98101

Attention: Thomas A. Sterken Re: Tyler Pipe Industries, Inc.
Registration No. C600 382 582
Tax Assessment No. 0719800

Dear Mr. Sterken:

Your appeal petition of March 31, 1981 to the Director of the Department of Revenue seeks to have Determination 81-39 set aside. The Determination was issued on March 12, 1981 without a hearing. It sets forth the facts and issues pertinent to the taxpayer's appeal covering an audit period from January 1, 1976 through September 30, 1980. Those facts and audit details will not be repeated here.

The taxpayer's current petition is simply a copy of the original petition which presented the taxpayer's position and cited case law supports for that position. Our review of Determination 81-39 reveals that it fully and properly represents the position of the Department of Revenue, under the prevailing case law and Revenue Rule 193B. The taxpayer's repetition of its arguments merely serves as an expression that it disagrees with the Department's position. No new or different arguments are proffered. Thus, it

clearly appears that no useful purpose would be served the taxpayer or the state of Washington by scheduling in an oral hearing of these matters. Further debate of the legal issues and constitutional authorities is unnecessary. Accordingly, the taxpayer's request for a hearing before the Director is hereby denied.

On the merits, Determination 81-39 sets forth the position of the Department which has been uniformly applied in cases such as this throughout many years of tax administration. In short, the most meaningful and significant activity engaged in here by the taxpayer's two selling entities, Tyler Pipe and Wade, Inc., is the sales related activity, including some solicitation, by "representatives" resident in this state, albeit they are independent agents. As Determination 81-39 explains, this fact alone—representatives performing significant services in relation to establishment and maintenance of sales—is sufficient to constitute nexus and gives this state jurisdiction to tax gross sales into Washington. It is fruitless to further debate whether the activities are significant or insignificant or whether the case law relied upon may be distinguishable in some factual patterns from the taxpayer's activities here. The simple facts are that the taxpayer's instate representatives do some soliciting, do forward and facilitate orders for goods, and do otherwise generally represent the taxpayer's interests in the Washington State sales market. It is patent that the most significant activity a seller can perform concerning a sale is getting the order. We simply cannot accept the taxpayer's position which argues, in essence, that it would pay commissions to sales agents here who perform no significant function.

We refer again to Determination 81-39, which is incorporated herein by this reference, as having fully responded to the taxpayer's petition arguments. It properly presents the position of the Department of Revenue in the face of the very constitutional tax challenges argued here. We concur with its findings and conclusions. Accordingly, the taxpayer's petition is denied.

Tax Assessment No. 0719800 has accrued additional extension interest of \$3,795, for a total of \$126,954, which is due for payment within twenty days from the date of this Final Determination.

Very truly yours,

STATE OF WASHINGTON
DEPARTMENT OF REVENUE

S. Ed Tveden, Assistant Director

cc: Tyler Pipe Industries, Inc.

IN THE SUPREME COURT
OF THE STATE OF WASHINGTON

NATIONAL CAN CORPORATION,
KALAMA CHEMICAL, INC., and
XEROX CORPORATION,

Appellants.

v.

STATE OF WASHINGTON,
DEPARTMENT OF REVENUE,

Respondent.

No. 51910-2
En Banc

UTTER, J.—This is a direct appeal from the trial court where various commercial enterprises (Taxpayers) claimed Washington's multiple activities exemption to the business and occupation (B&O) tax, RCW 82.04.440, discriminates against interstate commerce in violation of the commerce clause, U.S. Const. art. 1, § 8. The trial court ruled there was no unlawful discrimination. We agree and hold for the respondent, Department of Revenue (Department), that the challenged exemption does not violate the commerce clause. Our holding makes it unnecessary to reach the other issues raised by the parties concerning the constitutionality of both the tax refund interest provision, RCW 82.32.060, and the proposed legislation, ESSB, 3678, as well as the appropriate form of relief to be afforded Taxpayers.

Fifty-three separate actions for refunds of B&O taxes paid to the Department were filed. Each Taxpayer claimed the tax violates the commerce clause. These actions were joined for decision by the Thurston County Superior Court which granted the Department's motion for summary judgment and denied the Taxpayers' motions for injunctions against further collection of the

B&O taxes in question. The 53 cases were consolidated for this appeal and, in addition, 52 other substantially similar actions are pending in Thurston County Superior Court. The amount in question is estimated to exceed \$423 million.

Three plaintiffs were selected by the parties to serve as "test cases" in the appeal. Kalama Chemical, Inc., a representative plaintiff, manufactures its products in Washington and sells them outside of Washington. Xerox Corporation, the second representative plaintiff, manufactures its products outside Washington and sells them within Washington. The appellant in a companion case would appear to fit most closely within this category of plaintiffs. *See Tyler Pipe Indus., Inc. v. Department of Rev.*, Wn.2d , P.2d (1986). National Can Corporation, the third representative plaintiff, manufactures products in Washington for sale outside Washington, and also manufactures products outside Washington for sale in Washington. Kalama Chemical, Inc. seeks a refund of the manufacturing tax it paid (\$495,000); Xerox Corporation seeks a refund of the wholesale tax it paid (\$1.5 million); National Can Corporation seeks a refund of both the manufacturing and wholesale taxes it paid (approximately \$900,000). The period in dispute is from 1980 to the present.

The issue before us is whether Washington's B&O tax exemption, RCW 82.04.440, violates the commerce clause because it (1) discriminates against interstate commerce, (2) is unfairly apportioned, or (3) is not fairly related to the services provided by the state.

Neither this court, nor the state Legislature, "is the final arbiter" of commerce clause issues. *See Southern Pac. Co. v. Arizona ex rel. Sullivan*, 325 U.S. 761, 89 L. Ed. 1915, 65 S. Ct. 1515 (1945). In an earlier challenge to this B&O tax, we recognized "our duty [is] to abide by controlling United States Supreme Court decisions construing the federal constitution." *Association of Washington Stevedoring Cos. v. Department of*

Rev., 88 Wn.2d 315, 318, 559 P.2d 997 (1977); *Department of Rev. v. Association of Wash. Stevedoring Cos.*, 435 U.S. 734, 55 L. Ed. 2d 682, 98 S. Ct. 1388 (1978). This court's rulings on the constitutionality of the Washington B&O tax have generally withstood the United States Supreme Court's scrutiny, *see, e.g.*, *General Motors Corp. v. Washington*, 377 U.S. 436, 12 L. Ed. 2d 430, 84 S. Ct. 1564 (1963); *Standard Pressed Steel Co. v. Department of Rev.*, 419 U.S. 560, 42 L. Ed. 2d 719, 95 S. Ct. 706 (1975), except when we have read the commerce clause too broadly and struck down the tax. *See Association of Washington Stevedoring Cos. v. Department of Rev.*, 88 Wn.2d at 318-20.

We find ourselves today in a similar situation. For over 30 years, Washington's B&O tax has been repeatedly upheld by the federal courts against charges that it discriminated against interstate commerce. *See B.F. Goodrich Co. v. State*, 38 Wn.2d 663, 231 P.2d 325, *cert. denied*, 342 U.S. 876, 96 L. Ed. 659, 72 S. Ct. 167 (1951). In *B.F. Goodrich*, we held that the B&O tax does not discriminate against interstate commerce because, under that law, all wholesalers are taxed identically. We relied on the theory that any multiple-tax burdens on interstate commerce, whereby out-of-state businesses must pay a manufacturing tax in another state plus a wholesale tax in Washington, were merely "an inevitable consequence of the power of the several states to tax". 38 Wn.2d at 669; *see also General Motors Corp. v. State*, 60 Wn.2d 862, 376 P.2d 843 (1962) (B&O tax upheld against charges of discrimination, applying the *Goodrich* analysis). The Supreme Court affirmed, *General Motors Corp. v. Washington*, 377 U.S. 436, 12 L. Ed. 2d 430, 84 S. Ct. 1564 (1964), but specifically declined to pass on the question of discrimination in the form of multiple-tax burdens because the appellant there failed to demonstrate any actual multiple-tax burden by showing that another state levied an equivalent tax.

In *Chicago Bridge & Iron Co. v. Department of Rev.*, 98 Wn.2d 814, 832, 659 P.2d 463 (1983), this court upheld the tax against

charges of discrimination in the form of multiple-tax burdens. The court cited *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 277 n.12, 57 L. Ed. 2d 197, 98 S. Ct. 2340 (1978), for the proposition that the multiple-tax burdens experienced by interstate businesses are a "consequence of the *combined* effect of different states' laws" and were not caused by Washington's taxing scheme. 98 Wn.2d at 832. The United States Supreme Court dismissed the subsequent appeal "for want of a federal question," *Chicago Bridge & Iron Co. v. Washington Dept. of Rev.*, 464 U.S. 1013, 78 L. Ed. 2d 718, 104 S. Ct. 542 (1983), which we understand to be a decision on the merits. *Washington v. Confederated Bands and Tribes of the Yakima Indian Nation*, 439 U.S. 463, 476 n.19, 58 L. Ed. 2d 740, 99 S. Ct. 740, *reh'g denied*, 440 U.S. 940, 59 L. Ed. 2d 500, 99 S. Ct. 1290 (1979).

Taxpayers assert, however, that a recent Supreme Court case, *Armco, Inc. v. Hardesty*, U.S. , 81 L. Ed. 2d 540, 104 S. Ct. 2620 (1984),¹ effectively overrules, *sub silentio*, these 30 years of Supreme Court doctrine. As a result of their reading of *Armco*, Taxpayers ask this court to strike down the state's B&O tax and refund all monies allegedly improperly received under it since 1980.

Due to factual differences between the West Virginia tax, challenged in *Armco*, see 104 S. Ct. at 2621-22, and the Washington

¹The decision has already provoked considerable comment. See Judson & Duffy, *An Opportunity Missed: Armco, Inc. v. Hardesty, A Retreat from Economic Reality in Analysis of State Taxes*, 87 W. Va. L. Rev. 723 (1985); Lathrop, *Armco—A Narrow and Puzzling Test for Discriminatory State Taxes Under the Commerce Clause*, Taxes 551 (August 1985); Lightburn & McArthur, *U.S. Supreme Court Ignores Unitary Issue in Armco, Inc. Opting for Discriminatory Finding*, 3 J. of St. Tax'n 211 (1984); Note, *A Call for Internal Consistency Among State Taxing Schemes: Armco, Inc. v. Hardesty*, 38 Tax Lawyer 519 (1985); Sup. Ct. Holds West Virginia's Wholesale Gross Receipts Tax Unconstitutional, *The Tax Adviser* 487 (August 1984); *West Virginia Gross Receipts Tax Discriminates Against Interstate Commerce*, 3 J. of St. Tax'n 143 (1984).

tax, we do not believe the United States Supreme Court is requiring us to forge new commerce clause doctrine and disregard earlier decisions not overruled. We are unable to find such a command in the *Armco* decision. We are also troubled by the "free-rider" effect of Taxpayers' argument. As Taxpayers conceded at oral argument, their interpretation of *Armco* would force the State to forego taxing a substantial number of in-state transactions where state services had admittedly been furnished. This implies that a state, to make up the deficit, must impose a double tax burden on in-state manufacturer-wholesalers.

The Commerce Clause Issues

RCW 82.04.220 imposes, in general, a tax upon the privilege of engaging in business activities in Washington. The tax is measured by the application of rates against (1) the value of the products, (2) gross proceeds of sales, or (3) the gross income of the business, whichever is applicable. RCW 82.04.240 imposes a tax upon Washington manufacturers. RCW 82.04.270 taxes every person who sells products at wholesale in Washington. The disputed provision, RCW 82.04.440, provides that persons taxable under RCW 82.04.270 (wholesalers) shall not be taxed under RCW 82.04.240 (as local manufacturers). Thus, local manufacturers who wholesale their products strictly in Washington pay only the wholesaling tax. Further, a local extractor of a product who wholesales in Washington pays only the wholesaling tax, just as do out-of-state extractors. RCW 82.04.440. Under RCW 82.04.240, in-state manufacturers and extractors who sell their products out of state, pay only the manufacturing tax, at a rate substantially identical to that paid by in-state wholesalers.

A state B&O tax must pass a 4-prong test to be valid under the commerce clause: (1) There must be a sufficient *nexus* or connection between the taxing state and the business taxes; (2) the tax must be *fairly apportioned*; (3) the tax cannot discriminate against interstate commerce in favor of local commerce; and (4)

the tax must be *fairly related* to the services provided by the taxing state. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 51 L. Ed. 2d 326, 97 S. Ct. 1076 (1977). *Department of Rev. v. Association of Washington Stevedoring Cos.*, 435 U.S. 734, 55 L. Ed. 2d 682, 98 S. Ct. 1388 (1978). Appellants contend that Washington's B&O tax fails the last three prongs of this test. Because the heart of Taxpayers' complaint is that the statute fails the third prong, discrimination, that issue is addressed first. The second (fairly apportioned) and fourth (fairly related) prongs will be addressed together. Nexus is not at issue in this case, but is contested in the companion case. See *Tyler Pipe Indus., Inc. v. Department of Rev.*, — Wn. 2d —, — P.2d — (1986).

A. Discrimination.

A state's taxing scheme is discriminatory under the commerce clause if it grants a direct commercial advantage to local businesses or subjects interstate commerce to a risk of multiple tax burdens, to which strictly local commerce is not exposed. See *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 50 L. Ed. 2d 514, 97 S. Ct. 599 (1977); *Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434, 83 L. Ed. 272, 59 S. Ct. 325 (1939). Any direct commercial advantage to local businesses inherent in Washington's B&O tax results from duplicative tax burdens; e.g., the fact that strictly local businesses pay only one tax (either wholesale or manufacturing), while interstate businesses may possibly be subjected to one tax in this state and another tax at a different level of distribution in another state. Appellants contend that the recent Supreme Court decision, *Armco, Inc. v. Hardesty*, — U.S. —, 81 L. Ed. 2d 540, 104 S. Ct. 2620 (1984), controls where there is a possibility of multiple-tax burdens and requires the invalidation of Washington's B&O tax.

In *Armco*, the Court invalidated West Virginia's gross receipts tax, under which local manufacturers were exempted from payment of the wholesale tax when they sold their locally-manu-

factured products in West Virginia. Out-of-state manufacturers were required to pay the West Virginia wholesale tax when they sold their products in that state.

West Virginia's gross receipts tax is claimed to be the mirror-image of Washington's present tax. West Virginia granted strictly local manufacturer-wholesalers an exemption from its wholesale tax; Washington grants strictly local manufacturer-wholesalers an exemption from its manufacturing tax. Besides providing an exemption to taxpayers who have already paid one state excise tax, the two tax systems are similar in that they are gross receipts taxes.² Their points of difference, however, have become more noteworthy after the *Armco* decision. The West Virginia tax exacted substantially different tax rates on manufacturing (.27 percent) and wholesaling activities (.88 percent), which precluded the Court from finding that the wholesaling tax compensated for the manufacturing tax. *Armco*, 104 S. Ct. at 2623. By exacting substantially identical rates (.44 percent) for each activity, the Washington tax does not present the same obstacle to finding the taxes are compensatory.

In *Armco*, the Court held that West Virginia's tax facially discriminated against interstate commerce, 104 S. Ct. at 2622, because it provided that "two companies selling . . . property at wholesale . . . will be treated differently depending on whether the taxpayer conducts manufacturing in the State or out of it." *Armco*, 104 S. Ct. at 2622-23. The Court further determined that under the West Virginia tax scheme the manufacturing and wholesaling were not "substantially equivalent events" which would allow for the imposition of compensating taxes. *Armco*,

²The similarities were acknowledged by the Department when it was before the *Armco* Court. See Brief of Amicus, *Armco*, 104 S. Ct. at 2624. In oral argument before this court, however, the Department stated that the *Armco* opinion, with its emphasis on the rates and measures of the West Virginia tax, makes the differences between the two states' taxes more significant than their similarities.

104 S. Ct. at 2623. It also noted that West Virginia did not allow for a proportionate reduction of its manufacturing tax when the manufactured goods were sold out of state, but did allow such a reduction when the goods were partly manufactured out of state. This was taken as evidence that the manufacturing tax was "not in part a proxy for the gross receipts tax imposed on Armco . . ." 104 S. Ct. at 2623.

While the Court did not explain what it meant by "substantially equivalent events,"³ its reliance on *Maryland v. Louisiana*, 451 U.S. 725, 758-60, 68 L. Ed. 2d 576, 101 S. Ct. 2114 (1981), indicates a criteria to guide us in determining when the selling and wholesaling taxes would be deemed compensatory and therefore substantially equivalent. In *Maryland v. Louisiana, supra*, Louisiana claimed its first-use tax compensated for a severance tax the state had imposed on local natural gas production. The first use tax fell primarily on gas produced in the federal Outer Continental Shelf (OCS) and piped to Louisiana processing plants, before being distributed to out-of-state consumers. The Court stated the 2-pronged criteria for determining compensatory taxes: (1) both taxes must be designed to meet the same ends; (2) local and interstate taxpayers similarly situated must receive equal treatment. 451 U.S. at 758-59.

The Louisiana tax failed on both prongs of the test. The purpose of the severance tax was to protect Louisiana's natural resources and compensate for their depletion. The first-use tax, however, could not be designed for that same purpose, "since Louisiana has no sovereign interest in being compensated for the severance of resources from the federally owned OCS land." 451

³That the rate varies slightly for various types of businesses, is not germane to the present issue. The variance comes from a subsequently enacted surtax. RCW 82.04.2904. Moreover, mathematical equality is not required. *General American Tank Car Corp. v. Day*, 270 U.S. 367, 373, 70 L. Ed. 635, 46 S. Ct. 234 (1926).

U.S. at 759. The Court also noted that Louisiana's first-use tax directly altered market forces in three impermissible ways: (1) certain local uses of OCS gas were exempted from the tax; (2) its credit system encouraged "natural gas owners involved in the production of OCS gas to invest in mineral exploration and development within Louisiana" rather than continue to pursue out-of-state, e.g., OCS, development; (3) the credit system also assured that in-state end users of OCS gas would be insulated from the cost increases resulting from the first use tax. 451 U.S. at 757.

None of the skewed market behavior due to the Louisiana tax appears to have developed in West Virginia. The *Armco* Court, however, found that the lack of symmetry in the West Virginia tax structure demonstrated that the selling and manufacturing taxes did not share the same end. 104 S. Ct. at 2623. That West Virginia apportioned its manufacturing tax according to the percentage of in-state manufacturing a particular product represented, meant that West Virginia's selling tax could not be a substantially equivalent event for the manufacturing tax. In contrast, however, the flat rate character of the Washington taxes evidence the Legislature's intent to treat the two taxes as complementary and, therefore, compensatory.

Furthermore, the Washington B&O tax does not exhibit the infirmities that led the Court in *Maryland v. Louisiana, supra*, to conclude the first-use tax could not be a compensatory tax for the state's severance tax. The Washington B&O tax is designed to tax the privilege of engaging in business activity *within* the state. RCW 82.04.220. Both the selling and the manufacturing taxes are exacted to address the same state burdens attendant on granting such a privilege. All who engage in selling activity within Washington pay the selling B&O tax, while those in-state manufacturers who sell out-of-state are taxed on their manufacturing activity. Each Taxpayer is taxed only once, at a substantially

uniform rate,⁴ unlike West Virginia, for the privilege of doing business in Washington.

Nor does the tax exhibit a discriminatory impact. Unlike the Louisiana tax, the market forces are not altered by the incidence of the tax. In-state manufacturers selling out-of-state do not gain a tax advantage by shifting sales of their product to the local market. Similarly, out-of-state manufacturers selling in-state gain no tax advantage by moving their manufacturing operations in state. Also in contrast with the Louisiana tax is the fact that in-state consumers are not insulated from the price effects of the tax on the goods.

We are further persuaded that the Washington tax is valid because it is conceptually identical to the pre-1968 New York stock transfer tax the Court endorsed in *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 50 L. Ed. 2d 514, 97 S. Ct. 599 (1977) which was in turn reaffirmed in *Armco*, 104 S. Ct. at 2622. *Boston Stock Exchange* involved New York's attempt to keep the New York Stock Exchange by amending the stock transfer tax so that non-residents who completed transfers entirely in New York paid a lower tax than would residents, and that transfers occurring entirely within New York could only be taxed to a maximum of \$300, while there was no ceiling on other transfers. The tax was patently discriminatory and, unlike the B&O tax, was not part of a larger tax structure. The Court, however, spoke favorably of the unamended statute that taxed residents and nonresidents alike on one of several taxable stock transactions that could occur within the state. For both kinds of taxpayers, "the occasion of the tax was the occurrence of at least

⁴By way of example, the Court did suggest that sale and use taxes fell on substantially equivalent events. Other than representing activities farther downstream in the distribution chain, we do not see an economically significant difference between "sale and use" and "manufacturing and sale." *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 51 L. Ed. 2d 326, 97 S. Ct. 1076 (1977), requires some relationship between a legal distinction and "economic realities." 430 U.S. at 279.

one taxable event in the State, the rate of tax was based solely on the price of the securities, and the total tax was determined by the number of shares sold." 429 U.S. at 322-23.

The *Armco* Court relied heavily upon the *Boston Stock Exchange* case as authority for striking down the West Virginia tax. *Boston Stock Exchange*'s favorable treatment of the pre-1968 amendments, *see* 429 U.S. at 330, and the apparent centrality of that holding to *Armco* requires harmonization of the two opinions. The incongruities between Taxpayers' reading of *Armco* and earlier, well-established commerce clause cases, *see, e.g., Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 69 L. Ed. 2d 884, 101 S. Ct. 2946 (1981); *Complete Auto, supra*; *Boston Stock Exchange, supra*, makes us reluctant to extend *Armco* as Taxpayers urge. There is a disturbing formalism in their argument that manufacturing and wholesaling are never "substantially equivalent events." To read *Armco* thusly would foreclose analyzing a taxpayer's burden in light of both the structure of the relevant tax system and its effect on a single economic unit. Appellants' argument would force us to regard the gross receipts tax system as consisting of two separate taxes, manufacturing and selling, and to retreat from the *Complete Auto* "practical effects" test which *Armco* does not overrule or claim to modify. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. at 274. To do so would be to ignore the "economic realities," 430 U.S. at 279, that a business unit frequently operates at several levels in the distribution chain and the costs of those various operations come to bear on the single product which serves as the measure of taxation. *See also Judson & Duffy*, 87 W. Va. L. Rev. at 741; *Lathrop, Taxes at 552, 559.*

Similarly, to avoid other incongruities posed by Taxpayers' arguments, we do not read *Armco* as requiring that the "internal consistency" requirement be applied to determine discrimination. The concept, "internal consistency," originated in the fair apportionment analysis of a multi-state net income tax case, *Container*

Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 169, 77 L. Ed. 2d 545, 103 S. Ct. 2933 (1983), and its applicability to gross receipts tax cases has been questioned. See *Lathrop*, Taxes at 557. Nevertheless, the concept seems to have been used only to determine whether Armco, Inc. had to show actual harm once it had demonstrated the tax provision was facially discriminatory. See *Judson & Duffy*, 87 W. Va. L. Rev. at 739. As we have previously discussed, however, Washington's tax is not facially discriminatory. We note further that the Court, were it to have grafted the concept onto the discrimination prong, would have obscured the *Complete Auto* test by treating the "multiple taxation" apportionment prong as a discrimination problem. Reflecting its greater complexity, the "fair apportionment" prong has been subject to more generous standards than has the discrimination prong. See, e.g., *Container Corp.*, 463 U.S. at 170; *Moorman Mfg. v. Bair*, 437 U.S. 267, 278, 57 L. Ed. 2d 197, 98 S. Ct. 2340 (1978).

Because the West Virginia and Washington taxes differ significantly, we must reject appellants' argument and rely on the long history of the United States Supreme Court's treatment of this state's gross receipts tax as having withstood commerce clause challenges, see *Department of Rev. v. Association of Washington Stevedoring Cos.*, 435 U.S. 734, 55 L. Ed. 2d 682, 98 S. Ct. 1388 (1978); *Standard Pressed Steel Co. v. Department of Rev.*, 419 U.S. 560, 42 L. Ed. 2d 719, 95 S. Ct. 706 (1975); *General Motors Corp. v. Washington*, 377 U.S. 436, 12 L. Ed. 2d 430, 84 S. Ct. 1564 (1964); *Chicago Bridge & Iron Co. v. Department of Rev.*, 98 Wn.2d 814, 659 P.2d 463 (1983); *Crown Zellerbach Corp. v. State*, 45 Wn.2d 749, 278 P.2d 305 (1954); *B.F. Goodrich Co. v. State*, 38 Wn.2d 663, 231 P.2d 325, cert. denied, 342 U.S. 876, 96 L. Ed. 659, 72 S. Ct. 167 (1951), as well as the general development of commerce clause analysis from *Complete Auto* to *Armco*. See, e.g., *Container Corp. of America v. Franchise Tax Bd.*, *supra*; *Commonwealth Edison Co. v. Montana*,

supra; *Maryland v. Louisiana*, *supra*; *Moorman Mfg. Co. v. Bair*, *supra*. Under these two lines of precedent, we do not find the tax discriminatory.

B. Fair Apportionment; Tax Fairly Related to Services Provided by the State.

Taxpayers also claim that Washington's B&O tax violates the commerce clause because it is not fairly apportioned to reflect the amount of business conducted here, and it is not fairly related to the services rendered by Washington. As a result, Taxpayers complain that they are unfairly taxed upon more than 100 percent of their incomes. Hence, under the second and fourth prongs of the *Complete Auto* test, Taxpayers claim that interstate businesses are improperly subjected to multiple-tax burdens.

1. Fair apportionment.

Most apportionment cases have arisen in challenges to state income taxes where the income of a unitary multi-state business comes from a variety of tax jurisdictions. As Judson and Duffy note, a B&O tax on business activity within the state does not present the same difficulty in determining a nexus between business activity and the tax jurisdiction. *Judson & Duffy*, 87 W. Va. L. Rev. at 728. Moreover, even in the income tax cases, the Court has afforded legislatures a generous standard. In *Exxon Corp. v. Wisconsin Dept. of Rev.*, 447 U.S. 207, 219-20, 65 L. Ed. 2d 66, 100 S. Ct. 2109 (1980), the Court looked only to whether there was "a rational relationship between the income attributed to the State and the intrastate values of the enterprise." See also, e.g., *Container Corp. of Am. v. Franchise Tax Bd.*, *supra*. Earlier, the *Moorman* Court had refused to require Iowa to employ the favored 3-factor test, urged here by Taxpayers, instead of its single-factor test for apportioning interstate commerce income. To disturb the formula, the taxpayers in *Moorman* would have to show by "clear and cogent evidence" that the income attributed to the State is in fact "out of all appropriate proportions to the busi-

ness transacted . . . in that State' . . . or has 'led to a grossly distorted result . . .' " 437 U.S. at 274. The mere threat that income not generated in the state will be taxed under a formula does not make the formula constitutionally defective. 437 U.S. at 278. Congress, not the Court, must enact national uniform rules for the division of income if it finds duplicative taxation a problem. 437 U.S. at 279.

Washington's B&O tax has been held to be fairly apportioned in previous cases. *See Department of Rev. v. Association of Wash. Stevedoring Cos., supra; Standard Pressed Steel Co. v. Department of Rev., supra; Chicago Bridge & Iron Co. v. Department of Rev., supra.* Nonetheless, Taxpayers urge that, under *Armco*, the tax must now pass the "internal consistency" test articulated in *Container Corp. of Am. v. Franchise Tax Bd., supra*, and cited in *Armco*. In applying that test, the court must hypothesize that every jurisdiction has adopted a tax identical to the tax in question; the result must be that no more than 100 percent of a single business's income is taxed by one state.

We agree with the Department that the "internal consistency" test articulated in *Container Corp.* and *Armco* does not apply to the determination whether the B&O tax is fairly apportioned. This is because Washington does not tax the income of a unitary business, but rather taxes only the privilege of manufacturing or selling within the state. Thus, respondent urges that Washington's tax is apportioned by "allocation"; that is, the tax is applied only to the value of products manufactured in Washington or to the gross proceeds of sales in Washington.

We do not read the *Armco* opinion to apply its "internal consistency" test to the question of whether a state gross receipts tax is fairly apportioned. We believe that it does not apply not only because of the appeal of the Department's argument, but because the *Armco* Court said nothing about the status of *Washington Stevedoring*. *See* 435 U.S. 734. If the "internal consistency"

requirement applied to the fair apportionment prong, *Washington Stevedoring* should be overruled for requiring a showing of actual harm to make out unfair apportionment. 435 U.S. at 746 & n.16. Further, speaking specifically of the tax challenged here, the Court said, "[w]hen a general business tax levies only on the value of services performed within the State, the tax is properly apportioned and multiple burdens logically cannot occur." 435 U.S. at 746-47.

2. Fairly related.

The *Armco* Court did not address the "fairly related to state services" prong. The controlling case is *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 69 L. Ed. 2d 884, 101 S. Ct. 2946 (1981). Certain Montana coal producers and their out-of-state customers argued that they should be permitted to show that the state's high coal severance tax was not fairly related to state services provided. The Court refused to view the fair relation test as a cost-benefit analysis of the taxes paid and services received. The test is basically a nexus test, with "the additional limitation that the measure of the tax must be reasonably related to the extent of the [taxpayer's] contact" with the state. 453 U.S. at 626. The Court declined to determine what a reasonable measure might be because (1) no usable legal test could adequately reflect the varied considerations that "inform a decision about an acceptable rate or level of state taxation", 453 U.S. at 628; and, hence, (2) this is a question more suited to the political process. The taxpayer's "substantial privilege of mining coal" provided sufficient nexus and the only benefit the state needed to show was that the taxpayer enjoyed the "privileges of living in an organized society, established and safeguarded by the devotion of taxes to public purposes." 453 U.S. at 628-29. *See also Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 60 L. Ed. 2d 336, 99 S. Ct. 1813 (1979).

Manufacturing, or wholesaling, would also appear to be privileges comparable to mining so that the nexus requirement is

sufficiently met in the present case. Despite any warts Washington may suffer, the State can show that ours is "an organized society." While local manufacturer-sellers enjoy "two activities for the price of one", interstate businesses cannot, under this prong, apply a cost-benefit analysis to show how they have been short-changed.

We believe the Washington B&O tax continues to meet commerce clause standards. We do not believe *Armco* requires the result urged by appellants and can be reconciled with compelling precedent not overruled in *Armco* and with scholarly commentary. We also believe the controlling facts in *Armco* differ significantly from those before us. The trial court is affirmed.

We concur:

**IN THE SUPREME COURT
OF THE STATE OF WASHINGTON**

TYLER PIPE INDUSTRIES, INC.,
a Delaware Corporation,

Appellant,

v.

STATE OF WASHINGTON,
DEPARTMENT OF REVENUE,

Respondent.

MANDATE
No. 51110-1
Thurston County
No. 812007314

The State of Washington to: The Superior Court of the
State of Washington in and for Thurston County

This is to certify that the opinion of the Supreme Court of the State of Washington filed on March 6, 1986, became the decision terminating review of this court in the above entitled case on March 26, 1986. This cause is mandated to the superior court from which the appeal was taken for further proceedings in accordance with the attached true copy of the opinion.

Pursuant to Rule of Appellate Procedure 14.3, costs are taxed as follows:

\$380.22 in favor of respondent State of Washington,
Department of Revenue and against appellant Tyler Pipe Industries, Inc.

IN TESTIMONY WHEREOF, I have hereunto set my hand
and affixed the seal of said Court at Olympia, this 27th day of
March, A.D. 1986

Reginald N. Shriver
*Clerk of the Supreme Court,
State of Washington*

cc:

Cartano, Botzer, Larson & Birkholz

Mr. Thomas McKinnon

Mr. Thomas Sterken

Hon. Ken Eikenberry

Attorney General

Mr. James Tuttle, Asst.

Reporter of Decisions

**IN THE SUPREME COURT
OF THE STATE OF WASHINGTON**

TYLER PIPE INDUSTRIES, INC.,
a Delaware Corporation,

Appellant,

v.

STATE OF WASHINGTON
DEPARTMENT OF REVENUE,

Respondent.

No. 51110-1
Filed April 15, 1986

NOTICE OF APPEAL

Notice is hereby given that Tyler Pipe Industries, Inc., appellant, hereby appeals to the Supreme Court of the United States from the opinion and judgment entered in this action on the 6th day of March, 1986. This appeal is prosecuted pursuant to 28 U.S.C. Section 1257(2).

CARTANO, BOTZER, LARSON &
BIRKHOLZ

By: _____

Thomas A. Sterken
25th Floor
One Union Square
Seattle, WA 98101

CERTIFICATE OF SERVICE

It is hereby certified that service of the foregoing Notice of Appeal was made this 14th day of April, 1986, upon all parties required to be served by depositing a copy thereof in the United States Mail, first class postage prepaid, addressed to:

Mr. Kenneth O. Eikenberry,
Attorney General
Mr. James R. Tuttle,
Assistant Attorney General
Department of Revenue
AX-02
415 General Administration Building
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Mr. Thomas A. Sterken
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25th Floor
One Union Square
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APPENDIX G

Constitution of the United States:

Article I, Section 8, Clause 3

The Congress shall have Power *** To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes;

Amendment XIV

Section 1. All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

United States Code, Title 15:

§ 381. Imposition of net income tax

(a) **Minimum standards.** No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after the date of the enactment of this Act [enacted Sept. 14, 1959], a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

- (1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and
- (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such cus-

tomer to fill orders resulting from such solicitation are orders described in paragraph (1).

(b) Domestic corporations; persons domiciled in or residents of a State. The provisions of subsection (a) shall not apply to the imposition of a net income tax by any State, or political subdivision thereof, with respect to—

- (1) any corporation which is incorporated under the laws of such State; or
- (2) any individual who, under the laws of such State, is domiciled in, or a resident of, such State.

(c) Sales or solicitation of orders for sales by independent contractors. For purposes of subsection (a), a person shall not be considered to have engaged in business activities within a State during any taxable year merely by reason of sales in such State, or the solicitation of orders for sales in such State, of tangible personal property on behalf of such person by one or more independent contractors, or by reason of the maintenance of an office in such State by one or more independent contractors whose activities on behalf of such person in such State consist solely of making sales, or soliciting orders for sales, of tangible personal property.

(d) Definitions. For purposes of this section—

- (1) the term “independent contractor” means a commission agent, broker, or other independent contractor who is engaged in selling, or soliciting orders for the sale of, tangible personal property for more than one principal and who holds himself out as such in the regular course of his business activities; and
- (2) the term “representative” does not include an independent contractor.

Revised Code of Washington:

82.04.220 Business and occupation tax imposed

There is levied and shall be collected from every person a tax for the act or privilege of engaging in business activities.

Such tax shall be measured by the application of rates against value of products, gross proceeds of sales, or gross income of the business, as the case may be.

82.04.230 Tax upon extractors

Upon every person engaging within this state in business as an extractor; as to such persons the amount of the tax with respect to such business shall be equal to the value of the products, including byproducts, extracted for sale or for commercial or industrial use, multiplied by the rate of forty-four one-hundredths of one percent;

The measure of the tax is the value of the products, including byproducts, so extracted, regardless of the place of sale or the fact that deliveries may be made to points outside the state.

82.04.240 Tax on manufacturers

Upon every person except persons taxable under subsections (2), (3), (4), (5), (6), (8), (9), or (10) of RCW 82.04.260 engaging within this state in business as a manufacturer; as to such persons the amount of the tax with respect to such business shall be equal to the value of the products, including byproducts, manufactured, multiplied by the rate of forty-four one-hundredths of one percent.

The measure of the tax is the value of the products, including byproducts, so manufactured regardless of the place of sale or the fact that deliveries may be made to points outside the state.

82.04.250 Tax on retailers

Upon every person except persons taxable under subsection (9) of RCW 82.04.260 engaging within this state in the business of making sales at retail, as to such persons, the amount of tax with respect to such business shall be equal to the gross proceeds of sales of the business, multiplied by the rate of forty-four one-hundredths of one percent.

82.04.270 Tax on wholesalers, distributors

(1) Upon every person except persons taxable under subsections (1) or (9) of RCW 82.04.260 engaging within this state in the business of making sales at wholesale; as to such persons the amount of tax with respect to such business shall be equal to the gross proceeds of sales of such business multiplied by the rate of forty-four one-hundredths of one percent.

(2) The tax imposed by this section is levied and shall be collected from every person engaged in the business of distributing in this state articles of tangible personal property, owned by them from their own warehouse or other central location in this state to two or more of their own retail stores or outlets, where no change of title or ownership occurs, the intent hereof being to impose a tax equal to the wholesaler's tax upon persons performing functions essentially comparable to those of a wholesaler, but not actually making sales: *Provided*, That the tax designated in this section may not be assessed twice to the same person for the same article. The amount of the tax as to such persons shall be computed by multiplying forty-four one-hundredths of one percent of the value of the article so distributed as of the time of such distribution: *Provided*, That persons engaged in the activities described in this subsection shall not be liable for the tax imposed if by proper invoice it can be shown that they have purchased such property from a wholesaler who has paid a business and occupation tax to the state upon the same articles. This proviso shall not apply to purchases from manufacturers as defined in RCW 82.04.110. The department of revenue shall prescribe uniform and equitable rules for the purpose of ascertaining such value, which value shall correspond as nearly as possible to the gross proceeds from sales at wholesale in this state of similar articles of like quality and character, and in similar quantities by other taxpayers: *Provided further*, That delivery trucks or vans will not under the purposes of this section be considered to be retail stores or outlets.

82.04.290 Tax on other business or service activities

Upon every person engaging within this state in any business activity other than or in addition to those

enumerated in RCW 82.04.230, 82.04.240, 82.04.250, 82.04.255, 82.04.260, 82.04.270, 82.04.275 and 82.04.280; as to such persons the amount of tax on account of such activities shall be equal to the gross income of the business multiplied by the rate of one percent. This section includes, among others, and without limiting the scope hereof (whether or not title to materials used in the performance of such business passes to another by accession, confusion or other than by outright sale), persons engaged in the business of rendering any type of service which does not constitute a "sale at retail" or a "sale at wholesale." The value of advertising, demonstration, and promotional supplies and materials furnished to an agent by his principal or supplier to be used for informational, educational and promotional purposes shall not be considered a part of the agent's remuneration or commission and shall not be subject to taxation under this section.

82.04.440 Persons taxable on multiple activities

Every person engaged in activities which are within the purview of the provisions of two or more of sections RCW 82.04.230 to 82.04.290, inclusive, shall be taxable under each paragraph applicable to the activities engaged in: *Provided*, That persons taxable under RCW 82.04.250 or 82.04.270 shall not be taxable under RCW 82.04.230, 82.04.240 or subsection (2), (3), (4), (5), (6), or (8) of RCW 82.04.260 with respect to extracting or manufacturing of the products so sold, and that persons taxable under RCW 82.04.240 or RCW 82.04.260 subsection (4) shall not be taxable under RCW 82.04.230 with respect to extracting the ingredients of the products so manufactured.

82.04.500 Tax part of operating overhead

It is not the intention of this chapter that the taxes herein levied upon persons engaging in business be construed as taxes upon the purchasers or customers, but that such taxes shall be levied upon, and collectible from, the person engaging in the business activities herein designated and that such taxes shall constitute a part of the operating overhead of such persons.

(8) Supreme Court, U.S.

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No. 85-1963

IN THE
SUPREME COURT
OF THE
UNITED STATES
OCTOBER TERM, 1985

TYLER PIPE INDUSTRIES, INC.,

Appellant,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Appellee.

On Appeal From the Supreme Court
of Washington

MOTION TO DISMISS OR AFFIRM

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MOTION

Appellee State of Washington, Department of Revenue, moves the Court to dismiss the appeal herein or, in the alternative, to affirm the judgment of the Washington State Supreme Court, on the ground that the questions presented are so unsubstantial as to require no further argument.

STATEMENT OF THE CASE

Appellant, Tyler Pipe Industries, Inc. (TPI), challenges the imposition of Washington's wholesaling business and occupation (B&O) tax on its sales to Washington customers. We begin by describing Washington's tax sys-

tem in issue here, TPI's operations in Washington, and the contested tax assessment.

I. WASHINGTON'S B&O TAX

Washington's B&O tax is levied "for the act or privilege of engaging in business activities." Wash. Rev. Code § 82.04.220. J.S. G-2. This case involves the tax on the activity of selling at wholesale. The wholesaling B&O tax is imposed upon "every person * * * engaging within this state in the business of making sales at wholesale." Wash. Rev. Code § 82.04.270. J.S. G-4. The measure of the tax is the gross proceeds of sales, and the tax rate is .0044. *Id.*

Washington also imposes a tax upon the activity of manufacturing in this state. Wash. Rev. Code § 82.04.240. J.S. G-3. The imposition of the manufacturing B&O tax is limited by the so-called "multiple activities exemption," Wash. Rev. Code § 82.04.440. J.S. G-5. According to this provision, persons "taxable under * * * [wholesaling] shall not be taxable under [manufacturing] * * * with respect to * * * manufacturing of the products so sold."

The end result of these statutes is that *all* products sold at wholesale in Washington are subject to wholesaling B&O tax regardless of where they were manufactured. Also, all products sold at wholesale or manufactured in Washington are subject to one B&O tax, either wholesaling or manufacturing—but not both.

II. TPI'S OPERATIONS IN WASHINGTON

TPI markets plumbing pipes and related products, which are manufactured outside Washington by one or more of TPI's subsidiary corporations. The products are sold to TPI, which itself does no manufacturing. J.S. 4; RP 38.¹

¹References to the record before the Supreme Court of Washington are as follows: "FF" means the numbered Findings of Fact, J.S. Appendix B-8 through B-12. "RP" refers to the verbatim Report of Proceedings, the transcription of the trial. "CP" refers to the Clerk's Papers. "Ex." refers to a trial exhibit.

A. TPI's Marketing System

TPI's marketing division consists of two sales departments, DWV (Drainage, Waste, Vent) and Utilities. These departments do their local marketing across the nation through sales representatives, who are either employees or independent contractors. For most of Washington State, TPI does its marketing through two Seattle independent contractors. FF 2, 6, and 12, J.S. B-8, B-9, and B-11.

One of those contractors, Ashe and Jones, handles all sales functions in its territory pertaining to TPI products, except those relative to TPI subsidiary Wade, Inc.² Ashe and Jones, which also represents other companies with non-competing product lines, has four employees who sell for TPI. During the relevant period, Ashe and Jones was involved in \$22,345,110 worth of TPI Washington sales. Ashe and Jones receives a commission for every sale made in its territory to a TPI customer, even if the customer first directly contacts TPI rather than the sales representative about the sale. FF 3 and 6, J.S. B-8 and B-9; RP 281-82, 285; Ex. 17.³

The functions of Washington independent contractor Ashe and Jones are essentially identical to those of the employee salesmen who represent TPI in certain other parts of the country. There are no significant functional differences between these two types of TPI sales representatives. When Ashe and Jones personnel are asked by TPI to do something, they do it. They are TPI's agents. FF 12, J.S. B-11; RP 258, 305, 327.

²The DWV sales department includes Wade, Inc., a wholly-owned subsidiary of TPI which markets auxiliary items. Wade has its own Washington-based sales representative, Mechanical Agents, which maintains an inventory of Wade products (owned by TPI/Wade) in its warehouse in Seattle. FF 4, J.S. B-9. Mechanical Agents employs four sales people who engage in numerous Washington activities on Wade's behalf. RP 340-45. Although TPI originally contested the taxes measured by Wade sales, it abandoned that portion of its claim. CP 1-5; FF 1, J.S. B-8.

³In accordance with TPI custom, Ashe and Jones represents both the DWV and Utilities departments, and its commissions are calculated on the basis of both DWV and Utilities sales. RP 245, 248, and 262.

The sales representatives' functions can be broken down into three general categories, which we will now discuss in turn: (1) market information-gathering, (2) order solicitation and processing, and (3) market development and maintenance.

B. Market Information-Gathering

The sales representatives communicate frequently with TPI itself, TPI's customers, and even the customers of those customers, obtaining valuable information and relaying it back to TPI. Ashe and Jones personnel talk by telephone with TPI management in Texas, both DWV and Utilities, about a dozen times a week, providing information to both departments. RP 188-90, 255-56, 277-80; Exs. 13, 25.

Virtually all information received by TPI concerning the Washington market for its products is communicated orally from the sales representatives. Such information includes vital feedback about existing and potential new customers, product performance, competing products, pricing, market conditions and trends, existing and upcoming construction projects, customer financial reliability, and other critical information of a local nature concerning TPI's Washington market. Such information, provided on a regular, timely basis, is necessary to keeping TPI competitive in the marketplace. FF 8, J.S. B-9 and B-10.

C. Order Solicitation and Processing

TPI's sales representatives regularly call on the trade and solicit specific orders from wholesalers for TPI's products. They also regularly receive specific orders and transmit them to TPI. During the relevant period, the two Washington sales representatives actually received and conveyed to TPI 67% of its total orders from Washington customers. Ashe and Jones transmitted no Utility orders but 96% of the remaining non-Wade orders. FF 9, J.S. B-10; Ex. 49.

D. Market Development and Maintenance

In addition to soliciting orders as such, Ashe and Jones personnel spend a significant part of their time making "secondary calls" to persuade Washington architects and engineers, and contractors (the customers of TPI's customers), to specify and use TPI products in their projects. The representative does this for both the DWV and Utilities departments. FF 10, J.S. B-10; RP 287-89.

Even after an order has been obtained and placed, the sales representative has a follow-up role. If a Washington customer has a problem with non-conforming goods, shortages, or the amount of an invoice, that customer generally contacts TPI's local sales representative, who will participate in investigating and handling any adjustment. These contacts include inquiries about products sold by the Utilities department. FF 10, J.S. B-10; RP 169, 251, 302-03.

Finally, the sales representatives perform other important services for TPI. The sales representative is required by TPI's sales representation agreement to serve as the first line evaluator of a potential new customer's financial responsibility. Sales representatives also occasionally make inquiries for TPI regarding late payments. When there is a problem in this regard in its territory, Ashe and Jones will know about it and may become involved. FF 10, J.S. B-10 and B-11; RP 295-97; Ex. 41, ¶4.

In sum, TPI's sales representatives have long-established and valuable relationships with its customers. Through their sales contacts, the representatives maintain and improve TPI's name recognition, market share, and individual customer relations. They are involved in *all* TPI Washington sales transactions either actively or at least in the sense of being present, aware of the transactions, and available to assist if necessary. The sales representatives afford to TPI's customers the "presence" of TPI as they stand by at all times to assist the customers, encourage product sales, and promote TPI's goodwill. FF 7 and 11, J.S. B-9 and B-11; RP 162.

III. CONTESTED TAXES

TPI seeks a refund of wholesaling B&O taxes it has paid on its wholesale sales delivered to Washington customers, for the period from January 1, 1976 through September 30, 1980, in the total amount (including post-assessment interest) of \$130,010. FF 1 and 15, J.S. B-8 and B-12.

Neither TPI nor any subsidiary paid to any other state any tax measured in whole or in part by sales in Washington, or income resulting from those sales, during the relevant period. FF 17, J.S. B-12.

ARGUMENT

THIS CASE PRESENTS NO SUBSTANTIAL FEDERAL QUESTION AND THE DECISION BELOW IS CLEARLY CORRECT.

I. GENERAL MOTORS AND STANDARD PRESSED STEEL DISPOSE OF TPI'S CLAIM.

TPI claims that Washington's wholesaling B&O tax assessed here violates the Commerce Clause, Art. I, § 8, cl. 3, and the Due Process Clause, Amend. XIV, § 1, of the U.S. Constitution.

To be valid under the Commerce Clause a state's tax must satisfy four requirements: (1) there must be a sufficient connection or nexus between the interstate activities and the taxing state; (2) the tax must not discriminate against interstate commerce; (3) the tax must be fairly apportioned; and (4) the tax must be fairly related to the services provided by the state. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

The Due Process Clause imposes two requirements: (1) there must be a minimal connection between the interstate activities and the taxing state; and (2) there must be a rational relationship between the income attributed to the state and the intrastate values of the enterprise. *Mobil*

Oil Corp. v. Commissioner of Taxes of Vermont, 445 U.S. 425, 436-37 (1980). The Court has recognized that the Commerce Clause and the Due Process Clause tests in the area of state taxation are similar. *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois*, 386 U.S. 753, 756 (1967).

Washington's wholesaling B&O tax has repeatedly been upheld by this Court under both the Commerce Clause and Due Process Clause. See *General Motors Corp. v. Washington*, 377 U.S. 436 (1964); *Standard Pressed Steel Co. v. Department of Revenue of Washington*, 419 U.S. 560 (1975); and *Chicago Bridge & Iron Co. v. Department of Revenue*, 98 Wn.2d 814, 659 P.2d 463 (1983), appeal dism'd, 464 U.S. 1013 (1983). These decisions dispose of TPI's claim. The decision below, again sustaining the wholesaling B&O tax, correctly follows these cases.

It is clear that TPI considers these cases to be no longer controlling. J.S. 7. Why they should be so discarded, however, is far from clear. These cases have not been overruled and none of the Court's more recent decisions, including *Armco, Inc. v. Hardesty*, 467 U.S. 638 (1984), cast doubt on their continuing validity. Indeed, on the day the Court noted probable jurisdiction in *Armco* it dismissed the taxpayer's appeal in *Chicago Bridge & Iron*. See *Armco*, 464 U.S. 1016 (1983) and *Chicago Bridge & Iron*, 464 U.S. 1013 (1983).

We will establish that this appeal does not present a substantial federal question by discussing in some detail the Commerce Clause and Due Process Clause requirements. We begin, as TPI has, with the discrimination prong of the Commerce Clause test.

II. WASHINGTON'S WHOLESALING B&O TAX DOES NOT DISCRIMINATE AGAINST INTERSTATE COMMERCE.

A. The Wholesaling B&O Tax Does Not Provide a Direct Commercial Advantage to Local Business.

TPI alleges that Washington's wholesaling B&O tax discriminates against interstate commerce.⁴ J.S. 7-12. This precise claim was raised by the taxpayers in *General Motors*, 377 U.S. at 460 (Goldberg, J., dissenting). The majority in *General Motors* was not sufficiently troubled by the question to even discuss it.⁵ This was for good reason, as the Court's subsequent decisions show.

TPI's claim is based primarily on the assertion that the wholesaling B&O tax discriminates in the same way as the taxes struck down in *Armco* and *Maryland v. Louisiana*, 451 U.S. 725 (1981). J.S. 9. This assertion is incorrect. It stems from a fundamental misunderstanding of the Commerce Clause discrimination test that underlies both decisions.

1. The discrimination test under the Commerce Clause.

The discrimination test under the Commerce Clause embodies two basic principles. First, the Commerce Clause prohibits a state from imposing a tax "which discriminates against interstate commerce * * * by providing a direct commercial advantage to local business." *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 329 (1977). The Court has identified two kinds of taxes that violate this first principle.

The first improper tax *discourages* interstate commerce by using discriminatory taxes "to assure that residents trade only in intrastate commerce." *Boston Stock Exchange*, 429 U.S. at 334-35. Thus, a state "may not tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State." *Armco*, 467 U.S. at 642. This is the rationale of the majority in *Armco*.

⁴The same tax is also challenged in *National Can Corp. v. Department of Revenue*, 105 Wn.2d 327, 715 P.2d 128 (1986), appeal docketed, No. 85-2006 (June 3, 1986).

⁵This claim was raised again in the taxpayer's appeal of the Washington Supreme Court's decision in *Chicago Bridge & Iron*. This Court concluded that this claim did not present a substantial federal question.

The second kind of tax that violates the first principle of the discrimination test uses "discriminatory taxes to assure that nonresidents direct their commerce to businesses within the State * * * *." *Boston Stock Exchange*, 429 U.S. at 334-35. In this sense, such a tax improperly *encourages* interstate commerce. Based on this test the Court has struck down taxes which allow an interstate business to reduce its tax burden, in the taxing state, by increasing its business activities in that state.

The tax at issue in *Maryland v. Louisiana* illustrates such an improper tax. *Maryland v. Louisiana* concerned Louisiana's "first use tax." A credit to the first use tax made it possible for a business to reduce its Louisiana tax burden, e.g., from \$70 to \$35, if it did additional business in Louisiana. 451 U.S. at 757 (n. 28). The Court struck down the first use tax because it improperly encouraged an interstate business to increase its business in Louisiana in violation of the first principle of the Commerce Clause test.

The second principle of the discrimination test is the converse of the first: a state is not prohibited from structuring its tax system "to encourage the growth and development of intrastate commerce and industry" or "to compete with other States for a share of interstate commerce" so long as it does not "discriminatorily tax the products manufactured or the business operations performed in any other State." *Boston Stock Exchange*, 429 U.S. at 336-37. *Accord, Armco*, 467 U.S. at 645-46.

Thus, states are free to use taxes to encourage growth and compete for commerce so long as the taxes do not (1) tax a transaction more heavily when it crosses state lines or (2) allow an interstate business to reduce its tax burden, in the taxing state, by engaging in more business activities there.

*2. The wholesaling B&O tax is distinguishable from those struck down in *Armco* and *Maryland v. Louisiana*.*

With these principles of the discrimination test in

mind it is easy to see why the Court's decisions in *Armco* and *Maryland v. Louisiana* have no application to the wholesaling B&O tax.

TPI argues that Washington's wholesaling tax has the same infirmity as the wholesaling tax in *Armco*. J.S. 9. TPI's argument ignores the reasoning of the *Armco* Court. The Court invalidated West Virginia's wholesaling tax because it applied only "[i]f the property was manufactured out of the State and imported for sale." 467 U.S. at 642. In West Virginia no wholesaling tax was imposed if property was both manufactured and sold in the state.

This is not true in Washington. The wholesaling B&O tax applies to all sales in this state, without regard to where the goods are manufactured. Thus, Washington's wholesaling B&O tax does not discriminate by taxing a wholesale sale more heavily when it crosses a state line than when it occurs entirely within Washington.

TPI also argues that the wholesaling B&O tax discriminates because, it claims, the effect of Washington's multiple activities exemption, Wash. Rev. Code § 82.04.440, is the same as the credit struck down in *Maryland v. Louisiana*. J.S. 10-11. In fact, the effect of the credit in *Maryland v. Louisiana* and the multiple activities exemption are completely different.

Unlike the credit struck down in *Maryland v. Louisiana*, the multiple activities exemption does not permit an out-of-state manufacturer to reduce its Washington tax by increasing its business in this state. A business that manufactures \$1,000 of goods elsewhere and sells them in Washington at wholesale pays \$4.40 in wholesaling B&O tax (\$1,000 x .0044). If that business moved its manufacturing operation into Washington it would pay precisely the same wholesaling tax on the sale of \$1,000 of goods both manufactured and sold here. Thus, Washington's wholesaling B&O tax does not discriminate by assuring that interstate businesses direct their commerce into Washington.

3. *TPI's claim is really based on alleged infirmities in the manufacturing B&O tax.*

TPI argues that Washington's wholesaling tax is discriminatory, because under the multiple activities exemption, Wash. Rev. Code § 82.04.440, a business manufacturing and wholesaling in Washington pays only wholesaling B&O tax. But a business manufacturing elsewhere may be subject to two taxes imposed by two different states on its manufacturing and wholesaling functions. This result, TPI asserts, is a function of Washington's tax system. J.S. 8-9. However, the possibility of two taxes on an out-of-state business is not a function of Washington's multiple activites exemption. Another state could impose a manufacturing tax on products manufactured there even if Washington taxed both manufacturing and wholesaling (*i.e.*, if there were no multiple activities exemption), or if Washington imposed no manufacturing tax at all—on anyone.

Nor is such a result constitutionally infirm. The possibility—or actuality—of another state's tax on the manufacture of goods sold in a destination state does not of itself make the destination state's tax discriminatory, as the Court acknowledged in *Armco*. 467 U.S. at 645.

Accordingly, TPI must challenge the wholesaling tax because it is part of Washington's B&O tax system. By reason of the multiple activities exemption, that system is allegedly discriminatory since it imposes the manufacturing tax on those selling outside Washington and exempts, from that tax, those who sell within the state.

Thus, the nub of TPI's argument is reached: the wholesaling B&O tax should be struck down because the manufacturing B&O tax is discriminatory. TPI justifies this odd result by citing *Maryland v. Louisiana* for the proposition that a state tax must be "considered in conjunction with other provisions of a State's tax scheme." J.S. 10.

Obviously, we do not agree that the manufacturing

B&O tax discriminates against interstate commerce.⁶ However, even if it were so considered, TPI's conclusion about the corresponding invalidity of the wholesaling B&O tax it must pay would not follow from this result. If the Court concludes that a particular tax discriminates, based on its operation with other taxes in the state's tax system, it does not follow that every tax in that system must be struck down because of its possible relationship to the discriminatory tax.

Two examples should suffice. In *Maryland v. Louisiana* the Court struck down Louisiana's "first use tax." The Court gave no indication that the Louisiana severance tax, which was paid by every business that severed natural resources, was similarly invalid simply because the first use tax could be credited against it. In *Armco* the Court struck down West Virginia's wholesaling tax. Once again, the Court gave no indication that the state's manufacturing tax, which applied to all manufacturing in the state, was invalid.

Similarly, in this case, even if the manufacturing B&O tax were presumed discriminatory (and we contend it is not), that conclusion would not require striking down the wholesaling B&O tax which applies to all wholesale sales in Washington. Therefore, even if the manufacturing tax is regarded as discriminatory, TPI has no complaint.

B. The Concept of Internal Consistency Does Not Invalidate The Wholesaling B&O Tax As Applied to TPI.

TPI makes one additional argument. It contends that the court below erred because it did not apply the concept of "internal consistency" to invalidate the wholesaling B&O tax. J.S. 12. This argument fails for two reasons. First, the Court in *Armco* did not adopt an internal consistency test as part of its discrimination analysis. Second,

⁶In *National Can Corp. v. Department of Revenue*, 105 Wn.2d 327, 715 P.2d 128 (1986), appeal docketed, No. 85-2006 (June 3, 1986), some Washington manufacturers do challenge the imposition of Washington's manufacturing B&O tax upon them.

even if such a test were adopted, it would not invalidate the wholesaling B&O tax as applied to TPI; for TPI is not a manufacturer.

1. *Armco did not graft the concept of internal consistency onto the discrimination prong of the Commerce Clause test.*

Essentially, TPI argues that *Armco* grafted the concept of internal consistency onto the discrimination prong of the Commerce Clause test. TPI's argument amounts to this: even though the wholesaling B&O tax is imposed on *all* sellers, the concept of internal consistency renders that tax discriminatory. Thus, TPI would assert that under *Armco* the West Virginia *manufacturing* tax, which applied to all manufacturers, would have been held discriminatory. Yet there is nothing in the Court's opinion in *Armco* to indicate that both West Virginia's manufacturing and wholesaling taxes were infirm.

The Court's discussion of internal consistency in *Armco* actually was in response to West Virginia's argument that *Armco* be required "to prove actual discriminatory impact." 467 U.S. at 644. The Court rejected this argument. According to the majority, a showing of "actual discriminatory impact" by reason of another state's taxes

is not the test. In *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 169 (1983), the Court noted that a tax must have "what might be called internal consistency—that is the [tax] must be such that, if applied by every jurisdiction," there would be no impermissible interference with free trade.

467 U.S. at 644. The internal consistency test in *Container Corp. v. Franchise Tax Board* does not require one to prove actual discriminatory impact by pointing to another state's tax system.

In *Armco*, the Court stated: "A similar rule applies where the allegation is that a tax on its face discriminates against interstate commerce." 467 U.S. at 644. The "simi-

lar rule" is not the concept of internal consistency. It is not a rule which, as TPI asserts, allows the taxpayer to fashion a contention of facial discrimination when it is in fact subject to the same wholesaling tax imposed on all sellers engaged in wholesaling. J.S. 12.

Rather, the "similar rule" is the rule that actual discriminatory impact need not be shown where a tax discriminates on its face. The rule that actual discriminatory impact need not be shown is necessary because "[a]ny other rule would mean that the constitutionality of West Virginia's tax laws would depend on the shifting complexities of the tax codes of 49 other States * * * *"
Armco, 467 U.S. at 644-45.

Thus, the majority did not graft the concept of "internal consistency" onto the discrimination prong of the Commerce Clause test.

Both before and after its decision in *Armco* the Court has specifically refused to apply an internal consistency type test to the discrimination prong of the Commerce Clause. For example, in *Southern Pacific Co. v. Gallagher*, 306 U.S. 167 (1939) the Court considered a challenge to California's use tax. If the California sales and use taxes were placed in another state, goods purchased in that other state and brought into California would bear two taxes—retail sales tax and use tax; for the California use tax allowed no credit or other offset for another state's sales tax. Goods purchased in California and used in California, however, would bear only one tax—retail sales tax. Thus, internal consistency was the basis of the taxpayer's challenge.

If lack of internal consistency is a form of unconstitutional discrimination the Court should have invalidated California's use tax. It did not. Instead, the Court ruled that "this is not a discrimination in the law." 306 U.S. at 172. The Court in *Southern Pacific v. Gallagher* specifically refused to assume that another state had applied its sales tax because "[i]t will be time enough to resolve that argument 'when a taxpayer paying in the state of origin is

compelled to pay again in the state of destination.'" 306 U.S. at 172 (quoting *Henneford v. Silas Mason Co.*, 300 U.S. 577, 587 (1937)).

In *Williams v. Vermont*, ____ U.S. ___, 105 S.Ct. 2465 (1985) the Court specifically affirmed its earlier ruling in *Southern Pacific v. Gallagher*. *Williams* invalidated Vermont's use tax on motor vehicles. The Vermont sales and use tax lacked internal consistency. A nonresident would pay two taxes—the sales tax in the state of purchase and Vermont's use tax. A Vermont resident, buying in Vermont, would pay only Vermont sales tax.

The Court ultimately struck down the tax because the distinction between residents and nonresidents violated the Equal Protection Clause. 105 S.Ct. at 2472. However, the Court specifically adhered to *Southern Pacific v. Gallagher* and refused to apply an internal consistency type test. 105 S.Ct. at 2471.

Williams is especially significant because it was decided after *Armco* and *Armco* was specifically brought to the Court's attention. The pages of the Brief for Appellant (31-35) referred to by the Court, at 105 S.Ct. 2471, discuss its earlier opinion in *Armco*.

Southern Pacific and *Williams* confirm that the Court has not grafted the internal consistency test onto the discrimination prong of the Commerce Clause. Thus, the concept of internal consistency does not invalidate Washington's wholesaling B&O tax.

2. TPI is not a manufacturer and cannot suffer discrimination from a tax system that lacks internal consistency.

Even if the Court grafted internal consistency onto the discrimination prong of the Commerce Clause, the wholesaling B&O tax in this case is valid. Washington taxes, as applied to TPI, do not lack internal consistency. This is because TPI is not a manufacturer. It engages in only one business activity—selling. TPI admits that all of

the products it sells are manufactured by separate corporations which are its subsidiaries. J.S. 4.

Thus, even if another state had both a manufacturing and wholesaling tax, TPI would pay only wholesaling tax. It would never pay a manufacturing tax. In addition, there is no possibility of overlap between the wholesaling taxes of two states. A tax on selling can only be applied by the state of destination, be it Washington or another state. *Euco v. Jones*, 409 U.S. 91, 93 (1972).

Thus, Washington's wholesaling B&O tax, as applied to TPI, is internally consistent because TPI can only be subject to one wholesaling tax—regardless of whether it sells in intrastate or interstate commerce.

III. WASHINGTON'S SELLING TAX IS FAIRLY APPORTIONED AND FAIRLY RELATED TO SERVICES PROVIDED BY THE STATE.

TPI claims that Washington's wholesaling B&O tax is not fairly apportioned.⁷ J.S. 12-13. In doing so, TPI addresses neither the manner in which the wholesaling B&O tax is apportioned nor the decisions of this Court approving that apportionment method.

The wholesaling B&O tax is apportioned through the use of allocation. Washington allocates to itself only the gross proceeds of wholesale sales which are consummated by delivery within Washington. Thus, Washington does not use a three-factor formula, i.e., sales, payroll, and property, to divide up a taxpayer's gross income for the purpose of determining the base of the wholesaling B&O tax. But there is no constitutional requirement that Washington's method be broadened into this type of formulary apportionment.

⁷TPI also claims in the same heading of its discussion that the Washington tax is not fairly related to services provided by the state, but does not support this claim with any argument. Since the measure of Washington's tax is related exactly to TPI's sales activities in Washington, as required by *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 620-29 (1981), the lack of any actual argument appropriately forecloses that issue.

Washington's use of allocation to apportion its wholesaling B&O tax was specifically approved by this Court in *Standard Pressed Steel*, 419 U.S. at 564, where the Court stated that the wholesaling B&O tax was "apportioned exactly to the activities taxed."

Subsequently, in *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267 (1978) the Court relied upon *Standard Pressed Steel* in upholding Iowa's single factor apportionment formula. The Court stated, at 437 U.S. 280:

In *Standard Pressed Steel Co. v. Washington Revenue Dept.*, 419 U.S. 560, the Court sustained a tax on the entire gross receipts from sales made by the taxpayer into Washington State. Because receipts from sales made to States other than Washington were not included in Standard Pressed Steel's taxable gross receipts, the Court concluded that the tax was "apportioned exactly to the activities taxed."

The result in *Standard Pressed Steel* makes complete sense. The purpose of the apportionment prong of the Commerce Clause is to prevent multiple tax burdens. In this case, no multiple burden is possible because the Court has previously ruled that only the state of destination has jurisdiction to tax a sale. The Court has struck down taxes imposed on sales by states other than the delivery state. *Euco v. Jones*, 409 U.S. at 93; *J.D. Adams Manufacturing Co. v. Storen*, 304 U.S. 307, 311 (1938).⁸

IV. THE IN-STATE ACTIVITIES PERFORMED HERE CREATE A SUFFICIENT TAXING NEXUS.

TPI claims that there is an insufficient nexus, for Due Process and Commerce Clause purposes, between its ac-

⁸For this reason, TPI's assertion, at J.S. 13, that if other states were to adopt Washington's B&O tax "the same gross receipts would be taxed two, three or more times," is simply incorrect. One state, we would agree, might use gross proceeds as the measure for a tax on manufacturing, and another state, i.e., the market state, might use those same gross proceeds as the measure for a tax on selling. But *Armco* makes it clear that this is perfectly permissible. *Armco*, 467 U.S. at 645.

tivities and the State of Washington. This claim involves two arguments. First, TPI says that the activities themselves are insufficient, claiming that it has no employees, but only independent representatives with limited responsibilities, located in Washington. J.S. 14-15. Second, TPI claims that at least the sales of its Utilities department are dissociated from its other Washington activities and non-taxable. J.S. 15-16.

We will show that the facts in the record establish a more than sufficient nexus under this Court's decisions. TPI's dissociation claim represents merely a further attempt to disregard or retry the facts properly found below.

A. The In-State Activities Performed On TPI's Behalf Create a Sufficient Nexus For a Gross Receipts Tax.

TPI claims to have demonstrated that "the activities allegedly creating the required nexus were not of the same degree" as those performed in *Standard Pressed Steel*. J.S. 14. That claim simply ignores the functions which the courts below found to be performed on TPI's behalf by its local sales representatives. When these activities are reviewed, there can be no serious question of their sufficiency for nexus purposes.

In *Standard Pressed Steel*, the taxpayer was an out-of-state manufacturer with one employee, Martinson, residing in Washington. His primary duty was to consult with the Boeing Company regarding its anticipated needs and requirements for aerospace fasteners and to follow up any difficulties in the use of the fasteners after delivery. Orders and payments were sent directly to the taxpayer, not to Martinson. 419 U.S. at 561. Rejecting an argument that the in-state activities were too "thin and inconsequential," this Court unanimously concluded that "Martinson, with a full-time job within the State, made possible the realization and continuance of valuable contractual relations between [the taxpayer] and Boeing." 419 U.S. at 562.

Applying the same functional analysis here reveals that the activities performed by Washington residents on behalf of TPI are similar and even more extensive. TPI's Washington sales representative is similarly involved in gathering and conveying vital market information, resolving problems, and maintaining goodwill and rapport with customer personnel.

However, Ashe and Jones also does even more. TPI's representative actually goes out in the field and solicits, and processes, many orders. (Martinson, in contrast, "did not take orders." 419 U.S. at 561.) Ashe and Jones employs four sales people who, in addition to soliciting orders from TPI's numerous customers, also spend part of their time making "secondary calls" to persuade the customers of those customers to specify and use TPI products in their projects. Standard Pressed Steel had only one Washington resident, Martinson, calling only at the customer level, essentially on one customer.

Thus, the activities of TPI's sales representative here, involving market information-gathering, solicitation and processing of most orders, and related services aimed at developing and maintaining TPI's Washington market, provide a much broader nexus base than in *Standard Pressed Steel*. TPI's assertions to the contrary⁹ amount to a bald attempt to have this Court redetermine the facts, even though the Washington Supreme Court, after reviewing the entire record, concluded that there was "substantial evidence to support each fact" found by the trial court. J.S. A-6. This case does not present any reason for such an

⁹For example, the Washington courts found that TPI's Washington sales representatives convey virtually all the information TPI receives concerning the Washington market, information which "is necessary to keeping Tyler Pipe competitive in the marketplace." FF 8, J.S. B-9 and B-10; Ex. 24. TPI, though, without even acknowledging its payment to its representatives of commissions on *all* Washington sales, asserts that "it was not necessary to utilize an independent sales representative" to make sales in Washington. J.S. 15. Such a self-serving protestation, of the needlessness of services for which TPI paid valuable consideration, cannot be any more convincing in this Court than it was in the courts below.

exercise by this Court.¹⁰

Whereas *Standard Pressed Steel* supports the finding of nexus here, the cases cited by TPI, J.S. at 14, are all readily distinguishable because none forbade taxation of transactions involving resident agents of the taxpayer.¹¹ In *National Bellas Hess*, the taxpayer did not have in the taxing state "any agent, salesman, canvasser, solicitor or other type of representative to sell or take orders" or otherwise act on its behalf. 386 U.S. at 754. Similarly, *McLeod v. J.E. Dilworth Co.*, 322 U.S. 327, 328 (1944) involved a taxpayer whose only connection with the taxing state came through solicitation by traveling salesmen domiciled elsewhere.

In sum, the activities of TPI's Washington representative create a sufficient nexus for imposition of a gross receipts tax.¹² TPI's argument to the contrary could only succeed if none of these activities are attributable to TPI itself. Although TPI does not clearly so argue, we will briefly dispose of any such suggestion.

¹⁰This Court has indicated in recent actions that it will not retry nexus issues where the court below has reached a reasonable result consonant with the Court's own rulings. See *Illinois Commercial Men's Association v. State Board of Equalization*, 34 Cal.3d 839, 671 P.2d 349 (1983), *appeal dism'd*, 466 U.S. 933 (1984) (*Standard Pressed Steel* followed in finding sufficient nexus); *City of Phoenix v. West Publishing Co.*, 148 Ariz. 31, 712 P.2d 944 (1985), *cert. den.* 54 L.W. 3841 (1986) (*Standard Pressed Steel* distinguished in finding insufficient nexus).

¹¹Accordingly, we do not rely, as TPI infers, on the lesser nexus standard that suffices to impose use tax collection duties. J.S. 13-14. Cf. *National Geographic Society v. California Board of Equalization*, 430 U.S. 551 (1977).

¹²TPI claims that these activities would be insufficient for imposition of a net income tax, under 15 U.S.C. §§ 381 et seq., and that the Court should apply the same result as a constitutional rule even if the cited statute itself is only applicable to a net income tax. J.S. 14-15 (n.2). Given the facts showing that the representatives' activities here go far beyond mere "solicitation of orders," TPI's application of this statute is clearly incorrect. *Clairol, Inc. v. Kingsley*, 109 N.J. Super. 22, 262 A.2d 213 (1970), *affirmed*, 57 N.J. 199, 270 A.2d 702 (1970), *appeal dism'd*, 402 U.S. 902 (1971). Moreover, there is no basis for this Court to expand that statute to other activities, and to a gross receipts tax, when Congress itself has not seen fit to do so, in light of *General Motors and Complete Auto Transit* or otherwise.

B. That TPI Designates Its Local Sales Representatives As Independent Contractors Rather Than Employees Lacks Constitutional Significance.

As a factual matter, it is undisputed that the sales functions of TPI's Washington sales representative are essentially identical to those of the employee salesmen who represent TPI elsewhere. There are no significant differences in how this representative and those employees solicit and process orders or otherwise "call on the trade." FF 12, J.S. B-11.

As a matter of law, there also is no difference in the tax consequences. According to *Scripto, Inc. v. Carson*, 362 U.S. 207, 211 (1960), it does not matter for nexus purposes that a taxpayer's "salesmen" are not regular employees devoting full time to its service:

[W]e conclude that such a fine distinction is without constitutional significance. The formal shift in the contractual tagging of the salesman as "independent" neither results in changing his local function of solicitation nor bears upon its effectiveness in securing a substantial flow of goods into [the taxing state].

As this Court further explained, "To permit such formal 'contractual shifts' to make a constitutional difference would open the gates to a stampede of tax avoidance." *Id.*

Since the "contractual tagging of the salesman" is without constitutional significance in the use tax context, inescapably it is equally so for a gross receipts tax. TPI has never suggested any reason why its own subjective decision to designate sales personnel as independent contractors rather than salesmen, without any difference in their functions, should mean different tax consequences. Obviously such an artificial distinction would lead to the same "stampede of tax avoidance" regardless of the type of tax.

In any event, such an argument by TPI, based on its representative's independent contractor status, is foreclosed in this gross receipts tax context by *Illinois Com-*

mercial Men's Association v. State Board of Equalization, 34 Cal.3d 839, 671 P.2d 349 (1983), *appeal dism'd*, 466 U.S. 933 (1984). *Illinois Commercial* specifically found a sufficient nexus for imposition of a gross premiums tax on out-of-state insurance companies on the basis of the activities of in-state independent contractors. Those contractors were essentially the insurers' only link to California, a link limited to the contractors' investigation and (for one company) settling of no more than ten percent of filed claims. 671 P.2d at 354. Following *Scripto*, the California Court held that "the circumstance that investigation and/or settlement services" on behalf of the companies "were performed by independent contractors is of little constitutional significance. The undeniable fact is that they were acting as agents" of the taxpayers. 671 P.2d at 355.

This Court's subsequent dismissal of the appeal in that case, for want of a substantial federal question, constitutes a decision on the merits. *Hicks v. Miranda*, 422 U.S. 332, 344-45 (1975).

C. TPI Cannot Dissociate Its Utilities Department Sales.

TPI claims that the one-third of its sales attributable to the Utilities department "occurred with no participation whatsoever by the independent sales representative," and that under *Norton Company v. Department of Revenue of Illinois*, 340 U.S. 534 (1951) these are not taxable. J.S. 15-16. This claim represents yet another invitation to this Court to either ignore the facts found below or retry them. It also misapplies *Norton*.

Contrary to TPI's factual assertions, the record clearly establishes that the sales representative's activities made possible the realization and continuance of valuable contractual relations of TPI's Utilities department specifically. As we showed above, Ashe and Jones provides the same market information-gathering and market develop-

ment and maintenance services for Utilities as for DWV, with insignificant variations. TPI itself assigns these functions for both departments to this same representative, and pays that representative commissions on the total amount of all DWV and Utilities sales. The only significant distinguishing characteristic of Utilities sales, i.e., that the representative did not physically handle the orders, actually marks a similarity with *Standard Pressed Steel*, and thus certainly is no basis for a different result.¹³

Given these facts, *Norton* does not authorize dissociation of Utilities department sales. *Norton* forbade taxation only on transactions consummated directly with the taxpayer's out-of-state home office, presumably without any involvement of its local office personnel. 340 U.S. at 539. The Court's observation there that "no solicitors work the territory," 340 U.S. at 537, quickly distinguishes the present case, where Ashe and Jones is performing and being paid for numerous services which promote Utilities department sales.

¹³In any event, it is TPI's burden to show that the operations of its Utilities department are "dissociated from the local business and interstate in nature." *General Motors*, 377 U.S. at 441. Having itself tied the DWV and Utilities sales activities together in one local representative, TPI has been unable to carry this burden.

CONCLUSION

For the foregoing reasons, the questions raised by this appeal are so unsubstantial as to require no further argument. Accordingly, this appeal should be dismissed or, in the alternative, the judgment below should be affirmed.

DATED this 16th day of July, 1986.

Respectfully submitted,

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No. 85-1963

In The
Supreme Court
Of The United States

October Term, 1985

TYLER PIPE INDUSTRIES, INC.,

Appellant

vs.

STATE OF WASHINGTON DEPARTMENT OF REVENUE,

Appellee

On Appeal from the
Supreme Court of Washington

REPLY TO MOTION
TO DISMISS OR AFFIRM

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No. 85-1963

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vs.

STATE OF WASHINGTON DEPARTMENT OF REVENUE,

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**On Appeal from the
Supreme Court of Washington**

**REPLY TO MOTION
TO DISMISS OR AFFIRM**

I.

THE SIMPLE ECONOMIC REALITY OF THE STATE OF WASHINGTON BUSINESS AND OCCUPATION TAX IS THAT IT IMPOSES A SINGLE TAX ON LOCAL BUSINESS AND A DOUBLE OR TRIPLE TAX ON OUT-OF-STATE BUSINESS AND IT THEREFORE DISCRIMINATES AGAINST INTERSTATE COMMERCE.

The Court, in *Armco, Inc. v. Hardesty*, U.S. , 104, S.Ct. 2620, reh. den. U.S. , 105 S.Ct. 285 (1984) struck down as violative of the Commerce Clause of the United States Constitution a West Virginia taxing statute that the State of Washington, in its *amicus* brief filed in that case, described as "very similar" to the statute that Appellant asserts is unconstitutionally applied to it in this case. The State of Washington now seeks distinctions and technical differences of no significance, economic or otherwise, in an attempt to undermine the Court's holding in the *Armco* case and to obscure the simple questions presented in this case.

Appellant sold on the wholesale level in the State of Washington products that it manufactured out-of-state,¹ but was subjected to the same amount of State of Washington taxes that an in-state manufacturing company paid on both its manufacturing and wholesale activities in-state. Although a Washington manufac-

¹Appellant sells on the wholesale level products manufactured by its two wholly-owned subsidiaries. These subsidiaries do not sell or distribute any products except through Appellant. The sole reason why Appellant and its subsidiaries were separately incorporated was to comply with technical Interstate Commerce Commission regulations regarding the transportation of manufactured goods that are no longer in effect. Appellant and its subsidiaries share the same officers and directors, occupy the same facilities and are engaged in the same business. The issue of the separate incorporation of Appellant's manufacturing divisions was first raised by the State of Washington in the appeal to the Supreme Court of Washington, but in any case has no validity since there is no economic substance to the separate incorporation of the manufacturing divisions.

turer is also required to pay the wholesale tax imposed upon Appellant, the Washington manufacturer is exempted from the manufacturer's tax on its in-state sales, which exemption is not available to out-of-state manufacturers. Washington does not have to tax manufacturers, but if it chooses to do so, it cannot subsidize through its taxing system manufacturers who sell in-state. As a result, in addition to paying its fair share of taxes in Texas and other states in which Appellant manufactures its products, Appellant also had to pay to the State of Washington the full tax burden of a company that operated solely in the State of Washington.

The most clear and concise condemnation of the Washington taxing scheme may be found in the Court's own words finding the West Virginia tax unconstitutional [with the relevant information pertaining to the Washington tax inserted in brackets for comparison at the relevant points]:

"[W]hen the two taxes are considered together, discrimination against interstate commerce persists. If Ohio [Texas] or any of the other 48 states imposes a like tax on its manufacturers—which they have every right to do—then Armco [Tyler Pipe] and others from out of state will pay both a manufacturing tax and a wholesale tax while sellers resident in West Virginia [Washington] will pay only the manufacturing [wholesaling] tax. For example, if Ohio [Texas] were to adopt the precise scheme here, then an interstate seller would pay the manufacturing tax of 0.88% [0.44%] and the gross receipts tax of 0.27% [0.44%]; a purely intrastate Seller would pay only the manufacturing [wholesale] tax of 0.88% [0.44%] and would be exempt from the gross receipts [manufacturing] tax."

U.S. at ; 104 S.Ct. at 2623-24. In *Armco*, the Court found that a statutory scheme that imposed upon out-of-state businesses a tax burden equal to 130.68% of that imposed upon in-state businesses unconstitutionally discriminated against interstate commerce. The Court should therefore find in this case that

a statutory scheme that imposes upon out-of-state businesses a tax burden equal to 200% of that imposed upon in-state businesses is no less discriminatory against interstate commerce.²

II.

THE STATE OF WASHINGTON ASSERTS NEXUS TO IMPOSE A GROSS RECEIPTS TAX WHEN THE ONLY IN-STATE ACTIVITY IS SOLICITATION OF SALES. THIS ASSERTION VIOLATES THE COMMERCE CLAUSE OF THE U.S. CONSTITUTION, AS HELD BY THE COURT, AND CONGRESSIONAL POLICY AS EMBODIED IN THE FEDERAL INTERSTATE INCOME TAX ACT.

Contrary to the statements made by the State of Washington in its Argument in Support of its Motion to Dismiss or Affirm, the issue in this case is not the number of employees (or deemed employees) of Appellant located in Washington, nor the number of differences between salaried employees and commissioned independent contractors. The issue is simply whether the solicitation of sales on behalf of Appellant in-state is sufficient, in the absence of any other local connections, to give the State of Washington the constitutional authority to tax Appellant.

Mere solicitation of sales in-state has been held by the Court to be insufficient nexus to subject an interstate company to local taxation. E.G., *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), *Norton Company v. Departmental Revenue*, 340 U.S. 534 (1951); and *McLeod v. J. E. Dilworth Company*, 322 U.S. 327 (1944). Likewise, Congress has declared as federal policy in the Federal Interstate Income Tax Act, 15

²The State of Washington also imposes a 44% tax on the extraction of raw materials in-state, but businesses subject to this tax are exempted if they also manufacture or wholesale in-state. Thus, a business that extracts raw materials in one state, manufactures in a second and wholesales in Washington would bear 300% of the tax burden of a like in-state business.

U.S.C. Sections 381 *et seq.* that solicitation of in-state sales is insufficient to establish nexus for a *net* income tax, which policy should also apply to a *gross* income tax, like the State of Washington Business and Occupation Tax, whose sole difference from a net income tax is that it allows no deduction from taxable income of business expenses.³

The State of Washington, behind its diversionary discussion of "market information," "goodwill" and "customer relations," very simply wants to tax a company that has no in-state office, no in-state facilities, no in-state operations and no in-state non-sales personnel. The sole activity that the State of Washington asserts as the basis for imposing its tax, no matter how many words it uses to describe this activity, is the solicitation of sales.

CONCLUSION

For the foregoing reasons, the Court should deny the State of Washington's Motion to Dismiss or Affirm and should note probable jurisdiction of this appeal.

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³Because no deductions are allowed under the Washington State Business and Occupational Tax, it imposes a greater burden upon interstate commerce than an income tax since a marginal or unprofitable business is burdened no less than a profitable business.

CERTIFICATE OF SERVICE

It is hereby certified that service of the foregoing Reply to Motion to Dismiss or Affirm was made this day of August, 1986, upon all parties required to be served by depositing three copies thereof in the United States Mail, first class postage prepaid, addressed:

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In The
Supreme Court of the United States
October Term, 1986

TYLER PIPE INDUSTRIES, INC.,

NOV 20 1986

JOSEPH P. MANNOL, JR.
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—0—
NATIONAL CAN CORPORATION, *et al.*,

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v.

STATE OF WASHINGTON
DEPARTMENT OF REVENUE,

Appellee.

—0—
**ON APPEAL FROM THE
SUPREME COURT OF WASHINGTON**

—0—
JOINT APPENDIX

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CHRONOLOGICAL LIST OF RELEVANT DOCKET ENTRIES IN CASE NO. 85-1963

1. May 20, 1981—Appellant Tyler Pipe Industries, Inc. files Complaint for Declaration of Invalidity of Tax Assessment and other relief in the Superior Court of the State of Washington for Thurston County. Docket No. 81-2-00731-4.
2. March 22, 1982—Stipulation filed by the parties that the Complaint filed in the Superior Court of the State of Washington for Thurston County is now an action for refund by the Appellant.
3. October 12, 1982—Appellant files Amended Complaint.
4. June 15, 1984—Memorandum Opinion by the Superior Court of the State of Washington for Thurston County denying Appellant's claim for refund.
5. August 8, 1984—Memorandum Opinion by the Superior Court denying Appellant's Motion for Reconsideration.
6. October 24, 1984—The Superior Court enters both Order Denying Motion for Reconsideration and Findings of Fact, Conclusions of Law, and Judgment.
7. November 9, 1984—Notice of Appeal to the Supreme Court of Washington filed.
8. March 6, 1986—The Supreme Court of the State of Washington sitting en banc affirms the Superior Court's decision denying Appellant's claim for refund. Docket No. 51110-1.

9. March 27, 1986—Supreme Court of Washington mandates case to the Superior Court of the State of Washington for Thurston County for proceedings in accordance with its decision affirming the trial court.
10. April 15, 1986—Appellant files Notice of Appeal to the Supreme Court of the United States with the Supreme Court of the State of Washington.

IN THE SUPERIOR COURT OF THE STATE OF
WASHINGTON FOR THURSTON COUNTY

NO. 81-2-00731-4

TYLER PIPE INDUSTRIES, INC.,
a Delaware corporation,
Plaintiff,
vs.

STATE OF WASHINGTON, DEPARTMENT
OF REVENUE,
Defendant.

AMENDED COMPLAINT—FOR REFUND OF TAXES
AND INTEREST PAID AND OTHER RELIEF

(Filed October 12, 1982)

By way of amendment to the Complaint for Declaration of Invalidity of Tax Assessment, Injunction and Other Relief previously filed herein dated May 28, 1981, and for cause of action against Defendant, Plaintiff states as follows:

1. *Notice of Appeal.* This Amended Complaint shall constitute a Notice of Appeal, if and as required by RCW Section 82.32.180, which governs tax refund actions.

2. *Plaintiff.* Plaintiff is a Delaware corporation which does not engage in business in the State of Washington, maintains no office in the State of Washington and transacts no business in the State of Washington. Plaintiff's principal office and place of business is in Tyler, Texas.

3. *Defendant.* Defendant is the Washington Department of Revenue which has assessed and collected the bus-

iness and occupation taxes with respect to which refund is sought herein.

4. Business of Plaintiff. Tyler Pipe owns several subsidiaries which are engaged generally in the manufacture and sale of pipe and plumbing products. In this case, the taxes for which refund is sought were assessed with respect to the gross receipts from sales in Washington of products manufactured and sold by Tyler Pipe Industries of Texas, Inc. (hereinafter referred to as "Tyler Pipe"), a Texas corporation, which maintains its principal office and place of business in Tyler, Texas and which manufactures and markets many types of plumbing pipes and fittings through separate manufacturing and sales divisions within the Plaintiff's corporate family. Neither Plaintiff nor Tyler Pipe maintain or ever have maintained an office, plant or any other place of business in the State of Washington nor is either of such companies qualified to do business in the State of Washington. Neither company has or ever has had any employees located in or acting in the State of Washington, nor has either company sent any materials or products into the State of Washington except by U.S. Mail or independent common carrier. Neither company solicits sales in the State of Washington except through instrumentalities of interstate commerce, such as advertisements in national trade magazines and occasional mailings from out of Tyler, Texas. Neither company maintains or ever had maintained any assets or inventory in the State of Washington.

Sales of Tyler Pipe products to Washington customers are, and during the audit period were, handled through two sales representatives: Ashe & Jones, Inc. and Bridgeport Sales, Ltd. The sales representatives act independently of

the Plaintiff, Tyler Pipe and each other. They are not under the supervision or control of Tyler Pipe and do not receive any marketing, administrative or financial assistance or counseling from the Plaintiff or Tyler Pipe. The sales representatives on their own solicit sales of Tyler Pipe products, and each sales representative also handles the plumbing products of various other firms and companies.

Most orders of Tyler Pipe products by Washington customers, usually wholesale plumbing or similar firms, are placed with Tyler Pipe in Texas by mail or telephone through Tyler Pipe's independent sales representatives in Seattle; some orders, however, are placed directly by the customer with Tyler Pipe. Orders are subject to the acceptance of Tyler Pipe in Texas. Neither Tyler Pipe nor Plaintiff has ever sent any personnel into the State of Washington for purposes of soliciting or accepting orders from customers. The products are shipped to the purchasing customer from Tyler, Texas by common carrier and the purchasing customer is billed by mailed invoice from Tyler, Texas. Customers' payments are made directly to Plaintiff; Plaintiff then credits the appropriate Tyler Pipe sales division. The sales representatives do not handle payments or assist in their collection. Complaints are handled directly between Tyler Pipe and the customer and are resolved over the telephone or through the mail. During the period of time at issue, neither Tyler Pipe nor Plaintiff ever sent any service personnel into the State of Washington.

Neither Tyler Pipe nor Plaintiff has ever utilized the Washington court system or other state services to collect any delinquent accounts or for any other reason than the

initiation of this present action contesting the State of Washington's taxing authority.

5. *Assessment and Payment of Tax.* The Washington Department of Revenue issued Assessment No. 071980 against Plaintiff under the Washington Business and Occupation Tax. The Assessment, which was for the period of January 1, 1976 through September 30, 1980, asserted a total tax liability with respect to the sale of products in Washington by both Tyler Pipe and a separate subsidiary of Plaintiff which manufactures and sells specialized plumbing products, Wade, Inc., in the amount of \$123,159.00, including interest. After exhausting its administrative remedies and ultimately being denied preliminary injunctive relief by the Washington Supreme Court, the Plaintiff paid the full amount of the Assessment on or about March 12, 1982, which included \$105,421.00 of business and occupation tax, \$29,229.00 of interest, and \$232.99 of court costs, for a total payment of \$134,882.99. (See Exhibit A hereto.)

As indicated above, taxes were assessed with respect to sales of products not only by Tyler Pipe, but also with respect to products sold by Wade, Inc., a separate subsidiary of Plaintiff. For purposes of this action, no refund is being sought with respect to those taxes paid with respect to Wade, Inc., which represent approximately \$4,531.50 of the total amount paid. Refund is, however, sought with respect to all taxes and interest allocable to sales of products by Tyler Pipe, which have been determined by Plaintiff as follows:

Tax Year	Tyler Pipe's Washington Sales	Allocable Taxes and Interest Assessed and Paid
1976	\$3,374,417	\$120,884.43
1977	4,012,559	23,749.58
1978	5,078,759	27,927.41
1979	5,873,029	28,985.94
1980	3,900,664	17,171.06
TOTALS	\$22,239,419	\$118,718.42

Plus allocable post-assessment interest of \$11,633.08.

Accordingly, refund is sought herein in the total amount of \$130,351.49.

6. *Violation of Laws.* The above-described taxes and interest should be refunded to Plaintiff, as hereinafter requested, for the following reasons:

6.1 The assessment of taxes herein violates the Due Process and Interstate Commerce Clauses of the United States Constitution since there is not a sufficient nexus or contact with the State of Washington to constitutionally impose the tax and since the amount of tax is not fairly related to the benefits, if any, received by Plaintiff and/or Tyler Pipe from the State of Washington.

6.2 Said assessment violates the Washington State Constitution since it deprives Plaintiff of property without due process of law.

6.3 The assessment of the taxes against Plaintiff in this case violates the Department of Revenue's own regulations purporting to define sufficient local nexus for application of the business and occupation tax in the case of sales or goods originating in other states to persons in

the State of Washington since the in-state activity of the Plaintiff and/or Tyler Pipe is not significantly associated in any way with the sales into the State of Washington under Rule 193B (WAC 458-20-193B).

6.4 Said assessment violates RCW 82.04.430(6) since such statute specifically allows a deduction for business and occupation tax purposes for amounts derived from business in the State which the State of Washington is prohibited from taxing under the United States Constitution or the laws of the United States.

6.5 The said assessment violates the Federal Interstate Income Tax Law, 15 U.S.C. § 381, et seq. (1959), which generally provides that no state shall have power to impose a net income tax on any income tax derived from within the state by any person from interstate commerce if activity of the potential taxpayer is limited, as in this case, to selling through independent sales representatives in the taxing state and certain other activities.

6.6 The Washington Business and Occupation Tax Law (RCW 82.04.220) which imposes a tax upon the gross receipts from the sale of products in the State of Washington, as applied to the Plaintiff in this case, violates the Interstate Commerce Clause and Due Process Clause of the United States Constitution and federal statutory law, specifically U.S.C. § 381.

WHEREFORE, Plaintiff prays as follows:

1. That this court order the Washington State Department of Revenue to refund the amount of \$130,351.49 representing interest and taxes payed by Plaintiff as herein alleged, including interest on such amounts provided by law.

2. That Plaintiff recover costs and attorney's fees incurred herein.

3. For such other and further relief as the court deems proper in the premises.

4. That the pleading be deemed amended in conformance with the proof of the trial of this case.

DATED this 20 day of September, 1982.

CARTANO BOTZER LARSON & BIRKHOLZ

By: _____
Thomas C. McKinnon

By: _____
Thomas A. Sterken
Attorneys for Plaintiff

IN THE SUPERIOR COURT
OF THE STATE OF WASHINGTON
IN AND FOR THE COUNTY OF THURSTON
No. 81-2-731-4
TYLER PIPE INDUSTRIES, INC.,
vs.
Plaintiff,

STATE OF WASHINGTON,
DEPARTMENT OF REVENUE,
Defendant.

BE IT REMEMBERED that on Monday, November 21, 1983, the above-entitled and numbered cause came on for hearing before the HONORABLE CAROL A. FULLER, Judge of the Superior Court, held at the Thurston County Courthouse, Olympia, Washington.

APPEARANCES

FOR THE PLAINTIFF: MR. THOMAS C.
McKINNON

FOR THE DEFENDANT: MR. JAMES R. TUTTLE
Assistant Attorney General

*(p. 2) (Defendant's Exhibits Nos. 1 through No. 44, inclusive, were marked for identification.)

The Court: The Court calls the matter of Tyler Pipe Industries, Incorporated, against the State of Washington. Present in the courtroom is counsel for the plaintiff, Tyler Pipe, Mr. McKinnon. Present also is counsel for the state, Mr. Tuttle.

The Court has had an opportunity to read the trial memoranda. I understand that there is a motion in limine at this time.

* Transcript of proceedings has been reproduced exactly as certified, including typographical and spelling errors.

Mr. McKinnon.

Mr. McKinnon: Yes, Your Honor. Before me proceed into that, I would also like to introduce to the Court a member of the Texas Bar, Mr. Peter J. Turner, a member of the law firm of Gardere & Wynne in Dallas, Texas.

I am requesting that he be allowed to sit at the counsel table for his trial, for the limited purpose of assisting. He is not going to take place in the trial. I asked counsel, and he says there is no problem.

The Court: And the Court will authorize that he sit at counsel table.

Are you ready to proceed with the motion in limine?

Mr. McKinnon: Yes, I am, Your Honor.

The Court: Mr. McKinnon.

(p. 3) Mr. McKinnon: At this time, Your Honor, plaintiff is moving the Court for an order in limine requesting that the defendant, its attorney and all witnesses, be directed to refrain from bringing up or testifying in any manner concerning the affairs of Wade, Incorporated.

Wade, Inc. is a Virginia corporation, as indicated in the affidavit which was submitted in connection with said corporation—or with this motion. It's a separate legal entity, although a subsidiary of Tyler Pipe Industries, Inc. It is engaged in a different business than some of the other entities involved in this suit.

Specially it's engaged in manufacturing of specification drainage products, some of which are manufactured by Tyler Pipe Industries of Texas, and Tyler Pipe Plastics Company, and some of which are purchased by Wade from affiliated manufacturers.

The business and occupation taxes which were assessed against Wade are not in issue in this lawsuit. Although Type Pipe is not conceding that there is sufficient nexus to warrant the measurement of, and the imposition of said taxes, we have not included in this particular matter, or we are not seeking a refund of the taxes paid by Wade.

There were specifically \$134,832.89 of tax paid, (p. 4) including the Wade figure. The Wade figure is a minimal portion of that total amount; approximately \$4,300. The balance, totalling \$130,010.56 were paid by Tyler Pipe for the activities of Tyler Pipe pursuant to the audit conducted by the state.

Now, the basis for this motion in limine is that it's admitted by virtue of the discovery conducted that the state is going to attempt to in effect bootstrap its argument by alleging that the activities involving Wade warrant the imposition of the tax on Tyler Pipe.

It is conceded that Wade has during the audit period, which is the years 1976 through the first nine months of 1980, maintained a small inventory in the State of Washington, which is maintained in Seattle at the offices of its independent—of an independent sales representative, Mechanical Agents, Inc., has nothing to do whatsoever with Tyler Pipe and the sale of articles manufactured by Tyler Pipe of Texas.

The legal authority for this particular motion is found in *General Motors v. Washington*, 377 U.S. 436, which we submit in effect held that each separate division of General Motors—this was a State of Washington case—that it had to be shown that there was sufficient contact or nexus for each separate division.

Also *Norton Co. v. Department of Revenue*, 340 U.S. (p. 5) But more importantly, by virtue of state law, specifically RCW 82.04.030 adopted by the department, Wade must be treated as a separate legal entity, and its activities would have no bearing on the imposition of the alleged—or the taxes against Tyler Pipe.

And I would call the Court's attention to WAC 458-20-203, which provides as follows:

"Each separately organized corporation is a 'person' within the meaning of the law, notwithstanding its affiliation with or relation to any other corporation through stock ownership by a parent corporation by the same group of individuals."

So we have two distinct legal entities involved here, Tyler Pipe Industries and Wade, Inc. They must be treated separately. They are recognized in the law as separate, and distinct legal entities, and this case has nothing to do with the activities of Wade, Inc.

For these reasons I submit the motion is proper and should be granted. Thank you.

The Court: Mr. Tuttle.

Mr. Tuttle: Thank you, Your Honor.

The Court: Let me ask a question before you start.

(p. 6) Is it possible for the Court to reserve the matter of the motion in limine until the conclusion of the testimony?

And the reason I ask that is perhaps there is really not very much testimony that is going to be introduced having to do with Wade, and perhaps it would be clearer

at that time to the Court whether or not Wade is indeed a separate subdivision. I have only your representations, and, of course, what's in the affidavit as this point to go on, and after testimony I would have a great deal more perhaps.

I don't mean to burden the proceedings, though. If there is really a great deal of testimony involved, then I probably should make that ruling at the very beginning.

Mr. Tuttle: I would submit that that's the case, that you should, because I think it's going to come up again and again. We're going to have a witness from Mechanical Agents, which is the Wade representative, and it's woven through the facts of the whole case. As far as we're concerned there is a considerable relationship. These are just different corporate subsidiaries of Tyler Pipe, the taxpayer.

So I think that you really do have to address that issue at the outset.

(p. 7) The Court: At the outset.

Mr. Tuttle: I think you should rule on it now, yes.

If I might add just one thing, particularly in response to Mr. McKinnon. I have read a lot of these nexus cases, out-of-state-seller cases, and I have yet to even see one that even limits that including of evidence along the lines that is suggested. The evidence always comes in, and the court gives the appropriate weight, and considers whether or not the activities of the so-called separate entity can be separated out.

But as we have pointed out in our memorandum, once a taxpayer submits itself to a state's taxing jurisdiction,

as Tyler Pipe has done to the extent of paying taxes and not requesting a refund for its Wade sales, then it has the —the taxpayer then has the burden to disassociate that local—that conceded local activity from its other activities to show that those sales are in no way related.

There is no case that I have ever seen that says that the taxpayer can meet the burden by getting the evidence excluding at the outset. These are all very fact intensive cases. All that evidence has to come in so the court can make its decision on the basis of (p. 8) the evidence.

The Court: Mr. McKinnon, do you have anything in rebuttal?

Mr. McKinnon: Yes, with reference to the issue Your Honor raised.

You certainly would have the prerogative, and Mr. Tuttle has indicated to me all the exhibits that he intends to offer, and the great majority of them have to do with Wade, but in response to his particular points again I would submit that under the law they are separate legal entities, and they are to be treated as such, and the WAC provision clearly specifies that.

Now, what's the relevancy of the activities of Wade, and the small inventory it maintains, when that is not in issue. What is in issue are the activities of Tyler Pipe. Again I submit that it's proper. He has to show for each separate legal entity that the requisite nexus is met, and the meeting of the nexus with respect to Wade does not prove that that requisite nexus or connection is met with respect to Tyler Pipe.

What I'm afraid of, and one of the main purposes of the motion, I submit that most of his case is going to have

to do with Wade, which I submit by virtue of the authorities cited, has nothing to do with the real (p. 9) issue. That is whether Tyler Pipe has the minimal connection necessary which would warrant the imposition of the taxes, and it's going to drag this thing out longer than would be necessary.

* * *

(p. 15) The Court: Mr. McKinnon, your first witness.

Mr. McKinnon: Yes, Your Honor. Before we proceed to the witness, I would like to read into the record certain facts which were admitted as a result of a request for admission of facts submitted by plaintiff in this matter. The admitted facts are as follows:

"Plaintiff is a corporation established under the laws of Delaware. It is registered to do business in the State of Texas and maintains its principal place of business in Tyler, Texas. It is engaged in the business of selling pipe, plumbing and related products.

2. Tyler Pipe markets, sells and distributes, cast iron, pressure and plastic pipe and fittings, and sells and distributes specification drainage products. Most of Tyler Pipe's customers, including those located in the State of Washington, are wholesale plumbing or similar firms. Tyler Pipe owns several subsidiaries (p. 16) which are engaged generally in the manufacture, marketing and sale of pipe and plumbing products.

3. All sales which are the basis for the B&O taxes imposed in this case are sales of cast iron, pressure and plastic pipe and fittings which are marketed by a division of Tyler Pipe or by a wholly-owned subsidiary of Tyler

Pipe which has since been merged into Tyler Pipe and continues to exist as a separate division within Tyler Pipe.

4. The taxes for which refund is sought in this case were assessed with respect to the gross receipts from sales by Tyler Pipe to Washington customers of products manufactured by Tyler Pipe Industries of Texas, Inc., or by Tyler Plastics Company, both of which are wholly-owned subsidiaries of Tyler Pipe. Tyler Pipe Industries of Texas, Inc., produced all of the cast iron pressure pipe and fittings sold by Tyler Pipe for delivery in Washington and Tyler Pipe Plastics produced all the plastic pipe and fittings sold by Tyler Pipe for delivery in Washington. Neither Tyler Pipe of Texas, Inc. nor Tyler Plastics engaged in any marketing, sales or distribution activities."

This was admitted:

"Subject to the qualifications that the taxes for which refund is sought were 'measured by' rather than (p. 17) 'assessed with respect to' the referenced gross receipts, and subject to the further qualification that the last sentence refers to activities in Washington State.

Tyler Pipe has never utilized the court system of the State of Washington to collect any delinquent accounts or for any other purpose."

This was also admitted:

"Subject to the qualifications attendant to this lawsuit.

Tyler Pipe has no ownership or other interest in Ashe & Jones, Inc."

This was admitted:

"Subject to the qualification that the 'interest' referred to means an ownership interest.

The principal means by which the sales representative communicates with Tyler Pipe is by telephone.

The sales representative is paid solely on a commission basis according to the volume of sales of Tyler Pipe products in its geographic area. Tyler Pipe does not compensate, nor does it exercise any authority or control over, any employees or agents of the sales representative."

This was admitted:

"Subject to the qualification that the compensation and exercise of authority or control referred to in (p. 18) the second sentence mean 'direct' compensation or exercise of authority or control.

Tyler Pipe products are shipped to the purchasing customer from Tyler, Texas by common carrier or U.S. Mail. The purchasing customer is billed by Tyler Pipe by mailed invoice from Tyler, Texas. Customers' payments are made directly to Tyler Pipe."

This is admitted:

"Subject to the qualification that some Tyler Pipe products are shipped from a warehouse in Washington State."

Which, parenthetically, I'll say they are the Wade, Inc. separate corporation's products.

"All remittances from Washington customers during the audit period were mailed directly to Tyler, Texas or to

Tyler Pipe's lock box at First National Bank in Dallas, Texas.

No checks, drafts or other payments from Washington customers were sent to the sales representatives during the audit period.

Admitted—Subject to the qualification that only checks, drafts or other payments payable to Tyler Pipe are included.

The inside sales force's primary responsibility is to receive orders by telephone from customers nation- (p. 19) wide.

Once an order is accepted, it is first submitted to the data processing center of Tyler Pipe at its headquarters in Tyler, Texas. An invoice is prepared on an independent form bearing the name of 'Tyler Pipe Industries' and the company's logo, with the division name being added by the computer. The same invoice form is used for billing by all divisions."

This was admitted:

"Subject to a denial that the invoice form is an 'independent' form (whatever that means), and subject to denial of any implication that an order is necessarily accepted in Texas.

The invoice identifies Tyler Pipe Industries, Inc. as seller. No other sales documents are prepared. The original and two copies of each invoice are sent to the customer. One copy is retained and the Sales Department's file; one copy is sent to the Credit Department; one copy is sent to the sales representative. Tyler Pipe then credits the appropriate Tyler Pipe sales division."

This is admitted:

"Except for the second sentence (which is denied), and subject to the qualification that the word 'and' in the fourth sentence means 'in'."

(p. 19-a) And at this time, talking with counsel this morning, we are stipulating that the amount—exact amount of the refund sought is in the total sum of \$130,010.56.

Is that correct, Mr. Tuttle?

Mr. Tuttle: Yes.

Mr. McKinnon: That is the end of the stipulation.

At this time we'll call Mr. Horan.

(p. 20) (Witness sworn.)

JAMES B. HORAN

called as a witness herein, having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

By Mr. McKinnon:

Q Would you state your full name for the record, please, and spell your last name?

A James B. Horan, H-o-r-a-n.

Q What is your residence address, Mr. Horan?

A 2926 Keaton, K-e-a-t-o-n, Street, Tyler, Texas.

Q And what is your occupation?

A Senior Vice-President Marketing, Tyler Pipe Industries.

Q How long have you been employed by Tyler Pipe?

A 28 years, and a few weeks.

Q Can you just briefly give us your educational background?

A I finished through the third year in senior college.

Q And briefly relate the functions you have served at Tyler Pipe over the years.

A I have had varied job descriptions, and titles, beginning with, in 1954, when I first came with Tyler Pipe as assistant to the manager of the Tyler Specialty Company, (p. 21) a wholly owned subsidiary of Tyler Pipe Industries.

Q How long did you serve in that capacity?

A Through '56, at which time the manager resigned from the company to take other employment, and I was promoted to that position, and held the position through 1968—'58 excuse me.

Q Then what position did you assume?

A Tyler Specialty Company was dissolved, and merged into Tyler Pipe and Foundry Company at that time, and through the devices of catalogue rearrangement became catalogue sections of Tyler Pipe and Foundry Company, and I became manager of the Specification Drain Sales, Section 7—Division 7 of the Tyler Pipe and Foundry Company.

I held that position, and then included—promoted to include the Soil Pipe Division, as sales manager of Tyler Pipe and Foundry. Then held that position through 1960, at which time I was made sales manager of all sales divisions of Tyler Pipe and Foundry Company.

In 1963 I was promoted to an officer of the company as vice-president of Marketing. In 1977, December, I became senior vice-president of Marketing of Tyler Pipe Industries, which position I hold today.

Q Can you briefly tell us what your duties are as senior vice-president of Marketing?

A Well, as senior vice-president of Marketing I am challenged (p. 22) with the responsibility to monitor the activities of the marketing arm of the company, and help to make decisions about the activities of that department.

Q Briefly give us a summary of the nature of Tyler Pipe's business, just exactly what does Tyler Pipe do, and the type of products that are involved.

A Tyler Pipe's products are principally used in the construction of plumbing and—let me put it differently—fresh water and waste water plumbing piping systems for domiciles, commercial buildings, office buildings, factories, plants, and so forth.

Q Are there any divisions within Tyler Pipe of Texas, or does that—just briefly describe the type of business Tyler Pipe of Texas performs.

A Well, Tyler Pipe of Texas, through its manufacturing processes, spreads itself into several different divisions of the company in Texas. The Utilities Division, which manages the sale of those products peculiar to waterworks distribution. That is the fresh water side of my opening remark.

The DWV Division manages the sale of castiron and plastic drainage, waste, and vent piping and fitting products for use in the removal of waste water from domiciles,

offices and so forth. The Wade Division manufactures and distributes, rather, products auxiliary (p. 23) to plumbing piping systems.

Q Is Wade a separate corporation?

A Yes, it's a separate corporation.

Q Where is it incorporated?

A Delaware, I think. I'm not straight on that.

Q Now, are the items that are sold by the Utilities Division, and the DWV Division, manufactured by Tyler Pipe of Texas?

A Yes.

Q Okay. What does "DWV" stand for, by the way?

A It's a useful expression of drainage, waste, and vent piping systems, almost all of which vent to gravity. Whereas the Utilities Division, most of those products are under pressure while in operation.

Q Where is the manufacturing plant of Tyler Pipe of Texas located?

A It's located near Tyler, Texas.

Q And are all of the goods that are sold by the Utilities and the DWV Division manufactured in Texas?

A Yes.

Q How long has Tyler been in existence?

I want you to take into consideration any predecessor corporations, too.

A The founder of the company took control of a company called the Tyler Iron Company, in Tyler, in 1935. It

(p. 24) made things not at all required in the plumbing industry. So in 1937 it began to produce castiron soil pipe, and fittings, and auxiliary items, and offered them for sale to the plumbing trade.

Q Over the years has Tyler Pipe been involved in the manufacture and marketing of any unique type of products?

A I would think that the main marketing feature of Tyler Pipe has been over the period, its forefront activities in the unique new different types of product.

Q Can you briefly tell us about some of these products?

A In 1958 we produced the first ten feet lengths of castiron soil pipe ever made in the United States. It was very unique. It required what I call an industrial revolution, and that pipe was traditionally made by hand only in five foot lengths to suit the ability of the machinery to produce the finished product. It was sand rammed by hand once again into molds, and was a very slow process. Productivity soured.

Tyler went to Sweden and brought back a process called the Akers-Stykbruk process, where we spun material into iron metal cylinders and extracted a piece of pipe very shortly thereafter.

Q What was the significance of this particular product to the industry?

Mr. Tuttle: Your Honor, I would like to (p. 25) let the witness testify, but I don't see the relevance of this. I'll stipulate they make some good products. Why do we have to get into the description?

Mr. McKinnon: I'm just briefly asking him about some of these products for the purpose to show that in fact they are a nationwide corporation, and because of their type of products they are able to engage in the interstate marketing and sale of these products.

The whole point we're getting to is how necessary are the local sales reps. That is what it comes down to, is the key.

The Court: Objection overruled. I'll ask the court reporter to read back the last question.

(Record read.)

Q (By Mr. McKinnon) You have described the ten foot pipe. What is the significance of that to the industry of that particular product?

A Well, since the pipe is installed in various lengths, then in every case where the pipe could have been longer than five feet, it was restricted by product from all manufacturers. Tyler came on the market with a pipe that stretched out an additional five feet, and joined 12 inch, or 15 inch pipe with lead and oakum to bring forth a finished joint. Therefore we cut out many joints (p. 26) that the contractors were forced to make that they did not want to make.

Q Did that increase Tyler's sales?

A Our sales on that product, machinery, soared to require seven days of production. We sold that pipe in market places not represented by Tyler, because the desireability was such that we were contacted by telephone, mail, whatever, direct contact; please, can't I buy some of that ten foot pipe.

We took the pipe to the marketplace by the device of exhibitions, shows, contractors annual conventions, where we took a booth, so forth, to spread the word as rapidly as possible.

Q Do you have other types of products that are unique to the industry?

A Probably even equally, if not more significant, by virtue of the activity, we were able to retain the tolerance of the product, both inside and out, to the point where we could replace a lead and oakum joint with a joint made of rubber compound. That reduced the cost to the contractor, the installation cost.

I might add, as an aside, we had a two year lead on all competition on the ten foot soil pipe, and a two to three year lead on all competition on the plastic, because we sought a patent protection on the gasket, and (p. 27) all competitors stayed away from that until the patent was granted.

However, they did not have the productive capacity or control of their product dimensions to bring forth, and a compression gasket at that particular time.

Q Going now to the question of how Tyler Pipe advertises its products, and keeping in mind not only the two products you just mentioned, but other products, can you briefly describe the process that Tyler goes through?

A A very significant fact, I think is—to regress—when we moved the Tyler Specialty Company into Tyler Pipe, and produced a new catalogue, it was different and unique from the rest of the industry in that it was a loose-leaf binder, and permanently registered with all

holders, so additional incremental changes, or additions to our product line could be rapidly disseminated to all interested parties by a current updated mailing campaign.

Secondly, our advertising budget has been very large in comparison to others, in that we have advertised in all trade magazines, some regional magazines, some what we call house—for instance, the North Carolina Heat and Cooling Contractors has a little magazine of their own that describes the activities of that organization, and from time to time we expose ourselves with (p. 28) advertisements either describing the products, or the good name of Tyler Pipe, and so forth.

Q What about—you mentioned trade fairs, and exhibitions. How does Tyler Pipe handle its advertising and marketing at such functions?

A There are, throughout the year, regularly scheduled conventions, or trade shows. Conventions usually do not have exhibits. So you go to see customers from all over a region, or the United States, but the trade shows, which, once again, are regularly scheduled, Tyler Pipe takes various booth spaces, and determines which products it wants to show at that particular show, whether or not we'll have a convention suite to entertain after hours some of our customers, and so forth.

Q Are those, the trade shows you were referring to, national in scope?

A Some of them are. Some are regional in scope, some are cities. The American Society of Plumbing Engineers has local chapters throughout the country. We have some as simple as a table top seminar, and you take

your local representation, or the home office, certain unique products, to exhibit those products to the people who attend.

Q Are the attendees at most of these meetings, do they come from a national or regional basis?

A The larger ones, yes, national; international sometimes.

(p. 29) Q Now, calling your attention to the audit period involved in this particular lawsuit, which is, I think it will be stipulated, is the years 1960 through the first nine months—or '76, excuse me, through the first nine months of '80, how were Tyler Pipe products handled in the State of Washington.

I'm just talking about Tyler Pipe products.

A Well, they were—orders were received from customers in the State of Washington at Tyler's facilities in Texas, or to its representation here in the state.

Q What was that representation in the state?

A Well, we have two representatives in the time-frame; Ashe & Jones, who handled the Utilities Division, and DWV sales, and Mechanical—I'm sorry, I have forgotten the last word.

Q Mechanical Agents?

A Mechanical Agents, who handle our Wade Division only.

Q Okay. But I'm just calling your attention to the Utilities and DWV.

They were handled by Ashe & Jones?

A Ashe & Jones.

Q For a particular territory?

A Principally the State of Washington.

Q Did they also go outside the state?

A State of Montana.

(p. 30) Q Does Tyler have any ownership interest in Ashe & Jones?

A No, sir.

Q You know by whom Ashe & Jones is owned?

A Not precisely, although I think the principals are John Ashe and Glen Jones.

Q What type of materials were provided Ashe & Jones by Tyler Pipe?

A As in marketing materials?

Q Yes.

A Well, we would have, over the years, provided them with catalogues, principally; some fliers, brochures, broadsides. Things of that nature.

Q How are those materials provided, or how are they sent?

A By mail, or parcel post.

Q You send any material—well, strike that.

Who principally are your customers, say, in the State of Washington, during the audit period, to your knowledge?

A In the divisions we're discussing here?

Q Yes.

A Well, we have two lines of customers. The Utilities Division does business with wholesale utility suppliers, and the DWV Division does likewise through wholesale plumbing supply companies.

Q You send materials to—to these types of customers that (p. 31) you just testified to?

A Yes.

Q And what type of materials would you sent to them?

A We would send to them also catalogues, brochures, broadsides, advertising cut-sheets, through our regular mailing list held in Tyler, Texas.

Q How are those items sent?

A Sent by mail, or parcel post, depending on the bulk of the product.

Q Has Tyler ever maintained, owned, operated, or rented, any type of offices in the State of Washington?

A No.

Q What about—to your knowledge, has Tyler ever advertised in the State of Washington, utilizing local TV, radio, or billboards?

A No.

Mr. Tuttle: Objection. No foundation. How would he even know?

Mr. McKinnon: Well, I think I'm entitled to ask him.

The Court: Would you like to voir dire the witness?

VOIR DIRE EXAMINATION

By Mr. Tuttle:

Q Mr. Horan, do you have knowledge each time an advertisement (p. 32) is placed by Tyler Pipe, and where it's placed?

A Yes.

Q Each ad is personally run by you?

A Run by me? No.

Q I mean, is placed in front of you for review by you.

A The advertising is a yearly thing. We decide what we want to do, what trade magazines, what product, whether it's black and white, four color, whether it's one division, or another, and so forth. And I have final say, yes, and what the budget will be for the Advertising Department, so forth.

So do you review that in detail, or just put your stamp on it?

A I review it in detail.

Q You would have done that for each of the years of the audit period, '76 through '80?

A Yes.

Mr. McKinnon: Vocalize your answer.

The Witness: Yes. Even down to working on the literature, working the verbage, with your advertising agency in Dallas. They would be in my office. I don't like the way that reads. Let's revise this, and strike this.

Q (By Mr. Tuttle) You review the ads as well?

A The trade magazine ads. That is the highest cost in (p. 33) advertising. Truck ads, single page ads, half page ads, quarter page ads, bleed ads.

Mr. Tuttle: Nothing further.

The Court: Mr. McKinnon.

Mr. McKinnon: Could I have the last question I asked him.

I take it you have withdrawn your objection.

Mr. Tuttle: Yes.

Mr. McKinnon: Can I have that read back, please, and if there was an answer given, have that read back.

(Record read.)

DIRECT EXAMINATION (Cont'd.)

By Mr. McKinnon:

Q Can you briefly describe the process that an order goes through involving the Utilities Division, and the DWV Division, confining the answer to the audit period here in the State of Washington?

A Upon presentation of that order at headquarters, Tyler Pipe, Tyler, Texas, the order is then analyzed for, first of all, its content, and secondly its gross weight, and then that order is transmitted to a computerized typewriter, and a set of pages are prepared. And those pages consist of such things as shipping order documents, invoicing documents, and so forth.

(p. 34) That order is then—those pages necessary to the Shipping Department are transmitted to the Ship-

ping Department with a shipping date, and the order is gathered in accordance with that shipping document, and notice is given back to the Sales Department that that order is prepared for shipment either totally, or perhaps with certain line items in a negative balance.

So if we can't find that particular product in the yard, prior to shipment, that becomes and generates a backorder, and the whole process is repeated until such time as the original order is shipped complete.

Q Does the independent sales rep have any authority to accept an order?

Mr. Tuttle: Objection. That calls for a legal conclusion. What does "accept" mean?

The Court: Rephrase your question. You might ask what their procedures are with the independent rep.

Q (By Mr. McKinnon) Can you briefly describe the procedures with the independent rep, with the placement of an order?

A Well, if the order itself suits the parameters of acceptance from Tyler Pipe, then we just simply accept the order from the representative, if he is the purveyor of that order to our headquarters, and produce the documents I have described, and ship the material.

(p. 35) I don't guess I quite understand.

Q Let me rephrase that.

Does the independent rep have authority to bind the company for an order?

A No, sir.

Mr. Tuttle: Objection. Again it calls for a legal conclusion. That authority would be stated in a document, a contract, or something else, but it calls for a legal conclusion.

The Court: The objection is sustained. You may want to simply rephrase your question.

(Plaintiff's Exhibit No. 45 was marked for identification)

Q (By Mr. McKinnon) Handing you what has been marked for identification as Plaintiff's Exhibit No. 45, would you please tell the Court what that is?

A That document has a "Guide to Ordering" headline, and followed by "Conditions of Sale."

Q Where does that document come from?

A It's a part and parcel of the catalogue distributed to one and all.

Q When you say "to one and all," do the independent sales reps receive that type of catalogue?

A Yes.

Q And would Ashe & Jones have had that catalogue?

(p. 36) A Yes.

Q During the audit period?

A Yes.

Mr. McKinnon: I'll offer 45.

The Court: Any objection?

Mr. Tuttle: Let me just ask a couple questions.

The Court: Surely.

VOIR DIRE EXAMINATION

By Mr. Tuttle:

Q This guide and the conditions of sale, this page, as such, was included in the catalogue throughout the audit period; is that correct?

A That, or one of like nature, yes. I can't say if that specific one is that ole, but one of a like nature.

Q I don't see a date on it. Do you know if there would have been any changes during the audit period?

A Not substantially.

Q What changes would there have been?

A Only—really only in graphics.

Q So, to your knowledge, say, the conditions of sale, as stated here in —Plaintiff's 45, remains substantially unchanged from 1976 through 1980?

A Yes.

Mr. Tuttle: No more questions at this (p. 37) time.

The Court: Any objection to the admission?

Mr. Tuttle: No.

The Court: What has been marked for identification as the Plaintiff's Exhibit No. 45 will be admitted into evidence.

(Plaintiff's Exhibit No. 45 was received in evidence.)

DIRECT EXAMINATION (Cont'd.)

By Mr. McKinnon:

Q Calling your attention to the fifth paragraph of Exhibit 45, under "Conditions of Sale," could you just, for the record, read what that says?

A "All orders are subject to approval of our Home Office before final acceptance. Cancellation or changes in orders are not allowed without our consent. We reserve the right to refuse, cancel or backorder items not in stock or not manufactured by us, whether or not they are shown in this catalog."

Q After a sale has received approval from Tyler, briefly describe the process which the company goes through then in shipping the particular item that has been sold.

A Once again, from this transmission to the point, Tyler, Texas, we convert that order into documents. Satisfied (p. 38) to our requirements from the documents, we gather the material, and make shipment in accordance with the customer's requirements.

Q Those destined for the State of Washington during the audit period, to your knowledge how were they shipped?

A Shipped by common carrier, principally.

Q Is there any particular reason why the products are sold by Tyler Pipe Industries of Texas to Tyler Pipe Industries?

A I'm stuck on that one. I'm sorry.

Q Is there any ICC regulation?

A Either ICC, or perhaps SEC, since we were at one time a stock company.

Q To your knowledge, during the audit period, has any Tyler employee ever resided within the State of Washington?

A No.

Q To your knowledge, during the audit period, has Tyler ever sent any employees in the state for the purpose of designing, adapting, or repairing any product?

A No.

Q To your knowledge, during the audit period, has Tyler ever sent any service personnel into the State of Washington?

Mr. Tuttle: Objection. What is meant (p. 39) by "service personnel"? We don't have a foundation as to what that term means.

The Court: Please lay a foundation.

Q (By Mr. McKinnon) Does Tyler employ service personnel who repair or handle the products once they have been sold?

A No, sir.

Q During the audit period has Tyler Pipe paid taxes imposed or assessed by the State of Texas?

A Yes, sir.

(Plaintiff's Exhibits No. 46 and No. 47, were marked for identification.)

Q (By Mr. McKinnon) Handing you what has been marked for identification as Plaintiff's Exhibit No. 46, would you please tell the Court what that document is?

A This document is headed "Tyler Pipe Industries, Incorporated, State of Texas Franchise Taxes."

Q And for what period are the franchise taxes?

A 1976 through 1980.

Q Do you have personal knowledge of how that document was prepared?

A Yes, sir.

Q How was it prepared?

A It was prepared from records maintained at Tyler Pipe Industries, Tyler, Texas, for the payment of such taxes.

(p. 40) Q And handing you what has been marked for identification as Plaintiff's Exhibit No. 47, would you please tell the Court what that is?

A This document is headed "Tyler Pipe Industries, Ad Valorem Taxes," with subheadings of "School, State and County, Junior College, and Total," for the years 1976 through 1980.

Q Do you have personal knowledge of how that document was prepared?

A Yes.

Q How was that prepared?

A In the same fashion, by the use of records maintained at our headquarters in Tyler, Texas.

Mr. McKinnon: I'll offer 46 and 47.

Mr. Tuttle: I have to object to the relevancy. Maybe Counsel can explain the relevance.

Mr. McKinnon: Well, the relevance is, Your Honor, we get to the question of the proper apportionment, and the constitutionality of the taxes, and the purpose for the offering of this document is to show during the audit period Tyler Pipe was paying taxes in Texas on the products, or on the manufacturing, et cetera, the products that were ultimately sold to the State of Washington. So that we have in effect the double taxation.

(p. 41) Again, it just goes to the question of apportionment, and the fairness of the imposition of the B&O tax by the state, when all of the manufacturing, et cetera, took place in Texas on these products, and the plaintiff was paying taxes on these products, and I certainly think it's relevant to that point.

The Court: What have been—go ahead.

Mr. Tuttle: Your Honor, there is no showing of what the franchise taxes are paid for. That is what the incidence of the tax is, whether it's a proper tax, an income tax, a license, what, No. 1. And particularly with reference to the ad valorem tax I think it's well stated that the payment of property tax in one state does not create an unconstitutional double taxation as far as payment to another state, measured by the sales, the incidence being the privilege of making sales in another state.

So there is no—unless it were shown that these were taxes paid on the privilege of making the sales in the State of Washington, or perhaps on income from those sales, this is totally irrelevant. It's just another separate tax.

* * *

(p. 42) (Plaintiff's Exhibits No. 46 and No. 47 were received in evidence.)

* * *

(p. 43) By Mr. McKinnon:

Q Mr. Horan, during the audit period did Tyler Pipe maintain any inventory in the state of Washington?

A No, sir.

Q Has Tyler Pipe compiled a comparison of sales made to customers in the State of Washington during the audit period, comparing those that came through an independent sales rep vis-a-vis those that came through a telephone?

A Have we done so?

Q Yes.

A Yes.

Mr. McKinnon: Perhaps I could ask Counsel. I know he's intending to put this in anyway. If we could have a stipulation on these figures.

(p. 44) Mr. Tuttle: That would be Defendant's Exhibit 21 you're referring to. I think. It's been marked.

Mr. McKinnon: Yes.

Q (By Mr. McKinnon) Let me just ask you at this time, Mr. Horan, there is an attachment to Exhibit—Defendant's Exhibit 21.

Are these the figures that were compiled by Tyler Pipe?

A. Yes.

Q I would just ask you at this point in time to read into the record the comparison between the two figures.

The Court: Just so I'm clear, this is the comparison of sales that came through sales reps, as compared to those that came by telephone directly to Tyler Pipe?

The Witness: Yes. The manner of transmission.

The Court: Right.

The Witness: From sales representatives in the State of Washington for the year 1976, 1,371. 1977—

Mr. Tuttle: Your Honor, excuse me. May I have voir dire for a second on this?

The Court: Surely.

(p. 45) VOIR DIRE EXAMINATION

By Mr. Tuttle:

Q Were these prepared under your own supervision?

A My own supervision, yes.

Q Do they include sales for the Wade Division, or just —

A Yes.

Q This would be all sales to all Washington customers?

A Yes.

Mr. Tuttle: Thank you, Your Honor.

The Court: Surely.

The Witness: 1978, 1,442.

The Court: All right, you identified sales representative calls, 1,371. I have 1976.

The Witness: 1977, 1,615; 1978, 1,442; 1979, 1,693; first nine months of 1980, 1,507. And the total number of all orders for delivery in Washington during the audit period, that is all orders, 1976, 1,953; 1977, 2,329; 1978, 2,522; 1979, 2531—

The Court: Would you give me that figure again.

The Witness: 2,531. First nine months of 1980, 2,103.

Mr. McKinnon: Thank you.

The Witness: Yes, sir.

(p. 46) DIRECT EXAMINATION (Cont'd.)

By Mr. McKinnon:

Q During the audit period, Mr. Horan, did Tyler Pipe employ any people who promoted sales throughout the United States?

A Yes.

Q Can you briefly describe the nature of the activities performed by these people?

A By their title, they were denoted as sales promotion representatives. That means to us that they have no responsibility to secure orders, or to secure customers. Their prime function is to display to the marketplace a product unique in Tyler Pipe's kit, if you please, and further, where the requirement for a plumbing code variation is developed by this product change, they go to seek

at the plumbing code authority level approval of the product in that particular plumbing code.

Q Were these—or where do they reside, the people you just referred to?

A Three of them reside in Tyler, because that was their home, their domicile, and one in Denver, Colorado.

Q During the audit period, in order to make a customer aware of Tyler Pipe products, or or the—and services available in the State of Washington, was it necessary to utilize an independent sales rep?

(p. 47) A No, sir.

Q Why?

A Through the device of our catalogue, and its permanence, we are able to present to the customer, real or potential, a complete description of our entire product line, and services, and policies, through that catalogue device, and subsequently promotion pieces such as brochures and the like.

Q During the audit period, in the State of Washington, was it necessary, in order to make a sale, to utilize the services of an independent rep?

A To make a sale?

Q Yes.

A Not in every case, no.

Q Why is that?

A Well, by virtue of Tyler Pipe's activities in the other 49 states, by its relationship with multi-chain supply houses, and plumbing contractors, and even archi-

tectural engineers, we are able to display our product, point out its benefits, accept orders for the products with delivery instructions, without the total requirement of a local representation.

Q During the audit period did Tyler make sales internationally?

A Yes, indeed.

(p. 48) Q Could you briefly describe the type of sale?

A It was determined that Tyler Pipe had an opportunity to move its products into the international marketplace by virtue of the development of major foreign nations, such as Saudi Arabia, and Iran at the time, Iraq, and Jordan, and so on. We developed a disc company in accordance with federal statute, and exposed our product, and offered them for sale in all markets in the world.

Q Were any independent sales reps utilized?

A No. In this case we chose to develop a direct relationship with those potential and real customers in every case, and have at this moment no representation off our shore.

* * *

CROSS EXAMINATION

By Mr. Tuttle:

Q Mr. Horan, who is David Smart?

A David Smart is an employee of Tyler Corporation, located in Dallas, Texas. I think his title is assistant treasurer.

Q Tyler Corporation, is that the same as your employer?

A It's the parent company of my employer.

Q Is it the holding company?

(p. 49) A Yes.

Q Does he — I notice that he signed the interrogatory answers, all three sets of the answers to defendant's interrogatories.

Do you have any idea how he would come to do that?

Mr. McKinnon: Well, what's the relevance of that?

The Witness: No.

Mr. McKinnon: Your Honor, he signed as an officer — he's also an officer of Tyler Pipe Industries. I just wonder where we're going on that.

Mr. Tuttle: That is what I didn't hear, that he was an officer of Tyler Pipe Industries.

The Court: The objection is overruled.

Q (By Mr. Tuttle) That is your testimony, though, he's an officer of Tyler Pipe Industries?

A Yes. I'm going to — guardedly. I don't know what title he has at Tyler Pipe Industries, frankly.

Q Would his position be above or below yours?

A It would be parallel to mine, I would assume.

Q So he would have authority to act for Tyler Pipe Industries; is that right?

A Yes.

Q Your answer was "yes"?

A Yes.

(p. 50) Q Can you describe in a little more detail what the differences are between the products of the DWV, the Drain-Waste-Vent Division, and what I understand is a subdivision of the Wade Division?

A Okay.

Mr. McKinnon: Your Honor, just for the record, and in view of the motion, I am going to have an objection. I would like it to be a continuing objection as to testimony involving anything concerning Wade on the grounds of relevancy and materiality.

The Court: All right.

* * *

(p. 61) The Court: It occurs to me it doesn't make any difference whether they operate through ten different companies, or fifty, or a hundred. That certainly would not delineate the character of an association between Tyler Pipe and Wade. I think it would almost be a given, or agreed to, that there are many subdivisions of Tyler Pipe, and Tyler Corporation, but I'm not sure that it makes any difference how many there are.

* * *

(p. 70) The Court: All right. What has been marked for identification as the Defendant's Exhibit No. 5 will be admitted into evidence.

(p. 71) Mr. Tuttle: Could the witness be handed Defendant's 42.

Q (By Mr. Tuttle) Again, Mr. Horan, would you review that.

It consists, I believe, of the actual salary job descriptions, I believe they are called, for the same positions that the duties were listed in the previous exhibit.

A Yes.

* * *

(p. 72) Q (By Mr. Tuttle) I would like to call your attention to—on Defendant's 42 to the description for the DWV and Wade regional sales manager, which, I think, is right about the third or fourth down.

Now, that has references throughout to — let's — would you read the function?

A "Function: Under general direction of the vice-president — DWV Sales, performs a combination of selling and promotion duties pertaining to Wade products."

Q Could you explain why that says "Wade products"?

A No, I cannot. It's poorly written. There is an omission here that should be included, so as to include the DWV.

Q There are a number of other references in there, too. For example, 5 says: "Assist Wade sales manager

with territory sales analysis and projections; 6, Keeps Wade sales manager advised on competitive price conditions and keeps abreast of all situations affecting sales and marketing of Wade products."

A The language should be corrected then.

Q That would include then Wade and DWV; is that correct?

A Yes.

* * *

(p. 79) Q Oh, Tyler Pipe Industries, the Delaware corporation, is the parent. Then Tyler Pipe Industries of Texas is sort of the manufacturing arm?

A Manufacturing arm of the Marketing Division, if you please. It sells products, castings, if you please, to Wade. Wade being another company.

* * *

(p. 85) Mr. Tuttle: Could the witness be handed Defendant's 15. That consists of Interrogatory No. 13, (p. 86) and the answer thereto.

Q (By Mr. Tuttle) That interrogatory asked for the Washington contracts. I think it means "contacts," or was meant to mean "contacts" — it appears that the answer interpreted it that way — but would it be your testimony today that the three companies; that is Ashe & Jones, Bridgeport Sales, and Mechanical Agents, handled all sales functions pertaining to your products during the audit period?

A During the audit period.

Q Your answer is yes?

A Yes.

* * *

(p. 93) Mr. Tuttle: If counsel's objecting to the procedure, maybe I should ask Mr. Horan to put in his own words how did you receive market information about the Washington market.

The Witness: How did I personally?

Q (By Mr. Tuttle) How did Tyler Pipe, or any subsidiary —

A Receive market information about the Washington market? Principally through its representation or its customers (p. 94) in the marketplace.

Q By "representation," you're referring to sales representatives?

A Those current representatives of our company.

Q What kind of information would that be?

A It could have to do with the general business activity in the state. It could have to do with the competitive conditions within the state in the pricing of products of like nature.

Q For example, a competitor beating you on a price?

A Yes, that sort of thing, uh-huh.

* * *

Q So I understand, you would receive information about the competitive situation, particularly prices; is that correct, and about what else, about things that are going on as far as business?

(p. 95) A Personnel changes, the sale of our customers perhaps, activity at their level. I'm talking now all the way down to contractors. They are bellwether contractors. There is always a close relationship to pipe. We watch their good health. The Boeing Company's good health and activities indicates to us what downstream our activity may consist of.

Q You get that information from the sales representative?

A Or other sources. Yes, that is one of our sources.

Q Other sources would be what?

A Our wholesale customers, and other — our sales people operating in this marketplace.

Q Other sales people?

A Yes.

Q Who would that be?

A Well, someone friendly to us, who has a non-competing line might interject a comment along here that we may have missed.

Q What would you say your chief source of that information would be?

A Our chief source would be our representation.

* * *

(p. 103) Q Is the report — the answer indicates there is a report that is prepared monthly.

A There are reports prepared monthly, yes, quarterly and annually, accumulatively, and in dollars and cents, in tons or units of sales, and whatever fashion is of interest to the auditing person, if you please.

Q And that information is obtained from the sales representatives?

A Oh, no. I'm sorry. That's obtained internally from sales records.

Q I see. And that is all sales?

A Actual sales.

Q I heard you referring to finding out from the sales representatives about orders, prospective orders.

A That usually is in the area of forecasting events, either future or distant future events; forecasting.

Q Are the sales representatives then the source of that information, primarily?

A Yes

Q Your answer is yes?

A Yes.

Q How is that information important as far as the future? How is that important to you?

A Well, I must say it's probably subliminally computed into someone's mind as to the events that may or may not (p. 104) transpire in any given territory in any given time frame.

Q I was thinking, for example, I believe there was testimony in one of the depositions that it would perhaps

allow you to forecast how much inventory to build, adjustments in your production; would that be true?

A Well, I think I'm right in saying that our inventory positions are based on past history — immediate past history, daily past history practically, and, therefore, our forecasting for inventory position is more long time, how many tons do you think we ought to have for the upcoming quarter. That is adjusted for through — most recent history through the miracle of the computer.

* * *

(p. 146) Q Now, you testified on direct that Tyler Pipe Industries of Texas, which, I believe, is the manufacturing part of the family, sells to Tyler Pipe Industries for reasons of some sort of federal regulations. There was a leading question, I believe, to that effect, or in any case that was your testimony.

Can you explain that? Do you have any personal knowledge of what those regulations are?

A I do not.

(p. 147) Q So you wouldn't even necessarily know whether it's SEC, or ICC, or what, would you?

Would you verbalize your answer.

A No, I do not.

Q I believe you also testified that Tyler does not send any employees into the State of Washington for the purpose of adapting, designing, or repairing any products.

Was that your testimony?

A That is my testimony.

Q It's also been indicated through the answers to interrogatories that have been produced that there was some repairing of products that did occur through local vendors in the State of Washington; is that correct?

A That's correct.

Q Would it be fair to say then that any repairing that was necessary—I should say any adapting, or repairing of your products that was necessary in the State of Washington, once they were in the State of Washington, would have been done by a local vendor?

A They—

Mr. McKinnon: I'll object to the form of that question. It calls for pure speculation. He can ask him if he has any knowledge during the audit period of products repaired in the State of Washington, (p. 148) and that's been answered.

Mr. Tuttle: Let me rephrase.

Q (By Mr. Tuttle) Do you have any knowledge of any products being sent into the State of Washington, and thereafter being repaired, or adapted, by anyone other than a Washington vendor?

A I have no knowledge.

Q So, to your knowledge, any repairing or adapting that was done would have been done in the State of Washington?

The Court: Well, counsel, he just said he doesn't know, so I'm not so sure we can press him to assume something just because he doesn't know.

Mr. Tuttle: Well, I'm—well, I just—okay. Let me make sure.

Q (By Mr. Tuttle) Would there have been any other vendor outside the State of Washington to whom you would have presented a product for repair or adaption once it was in the State of Washington?

A No.

Q Now, you indicated that you did not send any employees into the State of Washington, any service personnel; was that your testimony?

A That is our testimony, yes.

Q And I think "service personnel" was defined in general (p. 149) as employees who would follow up on a sale, whatever action may be required after the delivery; is that correct?

Let me rephrase.

What do you mean by "service personnel"?

A Well, it's difficult to answer the question, because since we do not employ people that could be called by a table of organization, or job description, as service personnel. Not for Washington, not for any other state.

Q When you say you didn't send any service personnel into the state, you mean you just didn't send them into the state?

A Don't have such personnel.

* * *

(p. 160) Q (By Mr. Tuttle) What activities did you expect your sales representatives to be engaging in on your behalf (p. 161) in Washington State during the audit period?

A I suppose to remain aware of the construction activity that was taking place in the market at the time, to try to the best of their ability to keep watch over the competition, if you please, and furthermore, then, to promote the sale and use of our products through the normal channels of distribution.

Q Specifically, then, what contacts were you expecting them to make?

In other words, what types of businesses were they expected to contact on your behalf?

A A broad brush, our people are all expected to call on recognized wholesale plumbing distributors, mechanical contractors, architectural engineers, as desired and/or required for a particular purpose, plumbing inspectors, plumbing code authorities, and so forth.

Q Now, I understand that they were—what would be the purpose of calling on the wholesalers, specifically?

A To remind them, I suppose, that Tyler Pipe, and themselves, were in the marketplace and actively soliciting business, in the normal course of business.

* * *

(p. 162) Q (By Mr. Tuttle) What did you require of your wholesalers—excuse me—required of your sales representatives as far as actions in calling on wholesalers?

A Once again, as I stated before, to remind the wholesaler that Tyler Pipe was still seeking their custom, if you please, and that they, themselves, also were there to be of benefit to the wholesaler at whatever point possible.

(p. 163) Q What did you do—require them to do as far as assisting wholesalers in formulating their orders?

Mr. McKinnon: Your Honor, that's been asked and answered. He already said promotional things.

The Court: Go ahead, answer the question. You can answer the question.

The Witness: There are no such requirements.

* * *

(p. 165) Q (By Mr. Tuttle) You indicated that the sales representatives would be expected, or required, to contact contractors; is that correct?

Mr. McKinnon: Objection. He's misstating the testimony. He didn't say that they were required to do anything.

The Court: Well, he can answer that question.

The Witness: In their normal business activities, we would expect that they would do so. The requirement does not exist.

Q (By Mr. Tuttle) And why, then, would they—would the sales representatives be contacting contractors?

A To have a feel of the sense of the marketplace. Whether it's a dead marketplace, or a viable marketplace, an alive and vigorous marketplace, which contractors have work upcoming, and which do not, and so forth and so on.

Q How would that information then be—would that information be conveyed back to Tyler then?

A Not necessarily, no.

Q Would it usually be conveyed back to Tyler?

A No.

Q What use would be made of that information by the sales (p. 166) representative?

A So that he's know—I'm having to assume his purpose here in some sense—so he would know where to best spend his personal time.

Q But I believe you indicated that that was an expectation of Tyler that he be doing that.

Why would Tyler care about that?

A Well, so we'll—

Mr. McKinnon: Just a moment. I object to the form of the question, the way it's phrased.

The Court: I'm very uneasy also about this whole line of inquiry.

Now, read back the question as it was asked. I'll ask the reporter to do that.

(Record read.)

The Court: That is managing his own time. You might rephrase your question. I'll allow the question.

Q (By Mr. Tuttle) Why would Tyler be expecting a sales representative to contact the contractors to find out about how active the market is, and so forth?

* * *

(p. 167) The Witness: Our considered judgment, I suppose, that this will lead to a maintenance or improvement in market share, perhaps. It also assures that the contractor may become more aware of Tyler Pipe and its products available, and its services.

Q (By Mr. Tuttle) I believe you also indicated the sales representatives are expected by Tyler to be contacting engineers; is that correct?

A As the occasion demands.

Q What would the purpose for those contacts be?

A Generally to be a specific nature, like a project or a particular product, or service, available to the engineer whose inquiry may come triggered by advertising in trade magazines, or whatever origin.

Q As far as you're concerned, are these contacts that you have identified, that are made by the sales representative, are they essential to Tyler Pipe's maintaining or even expanding its competitive position in the Washington market?

A Not totally.

(p. 168) Q They are not essential?

A Not totally essential.

Q What do you mean by "not totally"?

A Well, you can arrive at the marketing of your goods and services through all kinds of devices.

* * *

(p. 169) During the audit period, besides sales representatives, what other means did you have for contacting wholesalers, contractors, engineers, and the other people you have identified?

A Through the media described previously. Through catalog presentation, through the advertising, and, of course, by telephone, telegram, and telex.

Q If a customer had a—and by "customer" I'm referring to—I refer to wholesalers—

Is that essentially who your customer would be?

A That is the first-line customer, yes.

Q That is who you actually invoice?

A Invoice through, and ship to or through, yes.

Q If a Washington customer had a problem with the amount of the invoice, nonconforming goods, any kind of a problem arising out of a transaction, who generally would the customer contact?

A He would general contact our local representation, if available, but many of them would escape that onerous attempt to try to find that man, and call directly to Tyler Pipe through our 800 numbers to our local telephone (p. 170) phone sales correspondent responsible for all sales in the State of Washington in the handling of the order itself.

Q Local sales correspondent?

A I'm talking about Tyler's headquarters. They know to call headquarters, and each department, for the matter which you just laid out.

Q Was there an 800 number during the audit period?

A I believe the deposition shows that part of that—part of the audit period. Otherwise they simply called collect. We accept collect calls from our customers, and always have.

* * *

(p. 176) Q (By Mr. Tuttle) Do those—how is it determined in a particular area whether to use a factory salesman or a sales representative?

Mr. McKinnon: Can I have a continuing objection to this line of questioning, Your Honor?

The Court: Surely. Mr. Tuttle, may I suggest that the question ought to be: Why did Tyler Pipe have sales people here who were independent contractors, rather than factory representatives, because that is what we're concerned with.

Q (By Mr. Tuttle) Why did you—why did Tyler have sales representatives in Washington during the audit period instead of factory salesmen?

A—During the audit period Tyler had sales representatives because Tyler estimated, perhaps, that the market would not generate enough income to Tyler, and/or its sales representative, for Tyler to have a subsidized factory salesman rather than an established local representation, with other lines, offering income to that organization.

Q You say did not offer enough of an opportunity to justify a subsidized salesman?

A Yes, to justify a salesman being not subsidized for his total cost of doing business.

(p. 177) Q Is it true that the factory salesmen, that are utilized elsewhere, are paid on a commission also?

A In part.

Q A commission based on sales?

A Yes.

Q Is there any difference, in your opinion, as far as how the sales representatives go about making sales, as opposed to how the factory salesmen make sales?

Mr. McKinnon: I won't object to that, but I take it now as a concession that this man is established as an expert witness, and can render opinion testimony. As long as that is understood on redirect.

Mr. Tuttle: Your Honor, I don't understand that. I'm just asking how they go about their jobs. What the differences are.

The Court: Well, I'm not so sure it's that important that he qualify as an expert witness. Certainly he can testify about the considerations in his own company.

Go ahead. You can answer the question, if you recall it.

The Witness: Would you repeat the question, please.

Mr. Tuttle: What is the—Would you read the question back.

(p 178) (Record read.)

The Witness: I would consider there would be no difference.

Q (By Mr. Tuttle) Do both the sales representatives and the factory salesmen have the same restrictions on their authority to accept offers, that is—

That is the question.

A Yes.

Q If you have a problem—if Tyler has a problem with a slow paying customer, slow paying wholesaler, do you have—do you utilize local sales representatives to contact that customer?

A Sometimes.

Q Would that be the usual course, usual procedure?

The Court: In the State of Washington, during the audit period.

The Witness: Not necessarily, no.

Q (By Mr. Tuttle) What other means are used then—were used in the State of Washington during the audit period?

A Conjecture would say that direct contact is made with the customer by our Credit Department.

* * *

(p. 183) DIRECT EXAMINATION

By Mr. McKinnon:

Q Would you state your full name for the record, please, and spell your last name?

A My name is Dale Meador, M-e-a-d-o-r.

(p. 184) Q What is your residence address, Mr. Meador?

A I reside at 1400 Everglades, Tyler, Texas.

Q By whom are you employed?

A Tyler Pipe Industries, Incorporated.

Q In what capacity?

A Vice-president in charge of Utility Division sales.

Q Can you just briefly give your educational background?

A I graduated from Baylor University; major in history, minor in political science.

Q Can you briefly relate your history with Tyler Pipe; when you commenced working with them, and in what capacity, from the time you started working to the present?

A Employed in 1958 as a sales clerk, Utilities Division. 1963 I became sales manager for the Utilities Division. 1977 became vice-president of Utilities Division sales.

Q Can you briefly describe what the Utilities Division is, and the type of products that are involved with the Utilities Division?

A Utilities Division sells castiron water main fittings for underground water distribution systems, and a few other related products.

Q Where are those products manufactured?

A Tyler, Texas.

Q Do you purchase any product from any outside company?

A No. A few accessories, but not the product itself.

(p. 185) Q Can you briefly relate how the Utilities Division operated within the State of Washington during the audit period in this case?

How a typical sale would be made.

A The Utilities Division, during the audit period in the State of Washington, sold their products through what we in the trade call waterwork distributors, or waterworks wholesale houses.

Q Just briefly, please tell us what a waterworks distributor and a waterworks wholesale house is?

A A waterworks distributor buys and resells products used in the—what we call the waterworks industry, which would be underground water distribution systems mainly, or pumping stations, water treatment plants, or waste water treatment plants.

Q Briefly describe how a typical order would come in, with reference to a sale in the State of Washington during the audit period.

A During the audit period, from the State of Washington, the order would be via a telephone call from a customer itself.

Q What would happen with the order once it's received in Tyler?

A Inside sales people that receive that order, it would be edited, coded for the computer, shipping papers

generated. Those shipping papers would be sent down to our (p. 186) Shipping Department. Based on the schedule, within a few days probably those products would be loaded via a common carrier, and transported to the State of Washington.

After the order is shipped, we would invoice it, bill the customer, and the customer would remit payment directly to the company.

Q During the audit period, did you ever visit the State of Washington?

A Yes.

Q Do you remember the date?

A I believe January, 1976.

Q For what purpose was that visit?

A Oh, generally to call on our customers, and express our thanks for the business, and generally promote the goodwill of our customers.

Q Do you recall with whom you met on that visit?

A I would say we met with, and called on all of the waterworks distributors that buy our product. Five or six different wholesale houses.

Q Did you meet with anyone from Ashe & Jones on that visit?

A Yes, I'm sure we did.

Q Other than that one visit you just related, in 1976, during the audit period, did you ever have any other (p. 187) occasion to visit the State of Washington?

This is strictly with reference to the audit period.

A Within the audit period I visited the State of Washington only once. That was that 1976 visit.

Q Do you know if there were any—or if anyone else from the Utilities Division made any visit to the State of Washington during the audit period?

A Yes.

Q Who was that?

A Gentleman by the name of Eldon Meadows.

Q What was his position?

A His title at this time is national accounts manager. His responsibility is somewhat the same as mine. He's sort of an assistant to me.

Q During the—what was the purpose of his visit to the State of Washington during the audit period?

A I think it would have been the same as mine. Generally to promote the goodwill of our customers.

Q How does the Utilities Division dispense information to its customers with reference to the products it has to sell?

A Utilities Division operates with a catalogue. That catalogue contains pricing information as well as technical information. Each customer is assigned a catalogue. It's a perpetual catalogue, and as changes occur they (p. 188) are mailed directly to that catalogue holder.

Q Are any changes that—in the catalogue, are they sent to Ashe & Jones, or in turn distributed to the customer, or sent directly to the customers?

A Those changes are sent directly to the customer.

Q What information, if any, is provided by the Utilities Division to Ashe & Jones.

I'll change that to was provided to Ashe & Jones during the audit period.

A I don't think much information would have come from us to Ashe & Jones. I think it would be the reverse. Probably some information would have come from them to us. I'm talking about marketing information. I know of no specific information that we would convey to Ashe & Jones.

Q If you did convey—

The Court: Just a moment. Am I to understand that you have these sales people out there from Ashe & Jones, and they're trying to sell your product, and you do not communicate any information to them, that it's just a one-way street from them to you?

Is that really your testimony?

The Witness: I'm sorry, I was speaking in terms of market information, Your Honor. Market information to us, is on prices to the trade, local information (p. 189) that would be of interest to us. We might have something take place nationally that we would pick up reaction here in this area.

As far as the catalogue information, the technical information, the pricing information, yes, Ashe & Jones gets a catalogue just like a customer would. We keep them abreast of what we're doing.

The Court: You're using that term in a very technical kind of way?

The Witness: Maybe I misunderstood the question.

The Court: No, I don't think you did. I think I misunderstood.

The Witness: Going back to the catalogue information, any new type of information, if we have some information that goes out to the customer, yes, they would get a copy of that information.

The Court: All right. I see. Please go ahead, Mr. McKinnon.

Q (By Mr. McKinnon) What type of information would Ashe & Jones provide the Utilities Division, or did provide the Utilities Division, during the audit period?

A Ashe & Jones would provide the Utilities Division with what we would call general market information.

Q Can you just briefly describe what type of information (p. 190) that is?

A Pricing in the—I'm talking about user prices, competitive factors that enter into the overall marketing situation, such as maybe some competitor come out with a new product. He would convey that to us. Maybe our customer's competitor's selling it at prices lower than he is. And possibly something has happened in the marketplace with regard to pricing, and they would convey that to us.

Q Was Ashe & Jones the exclusive purveyor of this type of information during the audit period, or did you get it from any other sources?

A No, we would get the same information from our customers.

Q How would you receive this information from your customers?

A Through the telephone, more than likely. Also maybe trade shows, and other areas where we would have communication with our customers outside the State of Washington.

Q Can you briefly describe what type of trade show you're referring to?

A Annually would be a national waterworks convention. It is a convention sponsored by the American Waterworks Association. There might be some, oh, smaller trade shows. Well, Waste Water and Water Equipment Association (p. 191) would sponsor a trade show of some sort. There has been some in years past where customers in this area would be at that show, and we have communication with them there.

Q What type of booth, or what would you provide at those trade shows?

A We would have a 20 foot booth, or ten foot booth, showing our products, showing anything new we might have, or generally a place to sit and discuss business.

Q During the audit period, would the—how would the Utilities Division receive an order?

Directing the question to whether you would get an order from the customer directly, or through Ashe & Jones.

Q Utilities Division receives their orders from water-works distributors directly from that customer, or distributor.

Q Is that true in most cases?

A Yes. In almost all cases, I would say.

(Plaintiff's Exhibit No. 49 was marked for identification.)

Q (By Mr. McKinnon) Handing you what has been marked for identification as Plaintiff's Exhibit No. 49, can you please tell the Court what that is?

A This is headed, "Tyler Pipe Industries, Inc., Number of Invoices Issued by Division." And then we have a number (p. 192) of orders transmitted by the sales representative broken down into two different categories. Those orders are transmitted by the sales representative, and those orders come directly from customers. It's laid out through the audit period of 1976 through the first nine months of 1980. It's broken down from Soil, or DWV Division, Utilities Division, and the Plastic Division. There is a total number there. And then they add the Wade Division, and then another total.

Q Was this document prepared since we were in court here this past week?

A Correct.

Q By whom was it prepared?

A It was prepared by our Accounting Division, based on my instructions.

Q Was it prepared in the general course of business of the Accounting Division based on the records that they have?

A Yes.

Mr. McKinnon: At this time I'll offer 49.

The Court: Any objection, Mr. Tuttle?

Mr. Tuttle: May I ask a couple questions?

The Court: Please go ahead.

Mr. Tuttle: You say this was prepared by the Accounting Division under your instructions.

(p. 193) Was that your testimony?

The Witness: Correct.

Mr. Tuttle: And it refers to the number of invoices issued. So that is the — that is an approximation then.

Is it the same as a sale in the State of Washington?

The Witness: Yes. An order would be received, and shipment made, then an invoice issued. So there has to be an order before you have an invoice. So the number of invoices, total invoices, would correspond exactly with the total number of orders received.

Mr. Tuttle: No further questions.

The Court: Any objection?

Mr. Tuttle: No.

The Court: What has been marked for identification as the Plaintiff's Exhibit 49 will be admitted into evidence.

(Plaintiff's Exhibit No. 49 was received in evidence.)

Q (By Mr. McKinnon) Calling your attention to Exhibit 49, just briefly tell us what that shows as to the Utilities Division, compare the sales received directly, or the sales that came through the sales rep Ashe & Jones?

The Court: Before you answer that, do (p. 194) you, Mr. McKinnon, have another copy of that document?

Mr. McKinnon: I just had two copies made. I'll get a copy made at the recess.

The Court: All right. You may have to be a little more detailed in your questions so I can follow, or maybe we can share. I think we can share this.

Mr. McKinnon: Can I have the last question, or do you remember the question, Mr. Meador?

The Witness: No. Would you mind repeating the question.

The Court: We'll have the court reporter read it back.

(Record read.)

The Witness: The exhibit shows the total number of orders received by the Utilities Division. Then it breaks down those number of orders as received directly from customers, and the number received from sales representatives. And it shows that we received none from sales representatives, and all came directly from customers.

Mr. McKinnon: That is all I have with reference to that exhibit.

The Court: All right. I'm having just a little trouble here. The reason was I couldn't read (p. 195) what was the heading there. All right.

Q (By Mr. McKinnon) Does the Utilities Division exercise any supervisory functions, or control, over Ashe & Jones and the manner in which Ashe & Jones operates its business?

A No.

Q Is the information received from Ashe & Jones necessary in order to enable the Utilities Division to make sales within the State of Washington?

A No.

Q Why is that?

A Because we have received a lot of information directly from our customers. Within the audit period we would have received this type of information from sales representatives. We would have dropped those sales representatives and changed to strictly house account. And that is — by that I mean we have no representation at all in an area within the audit period, and our market penetration was not affected seriously.

In fact one area — several areas — I think we probably increased our market penetration without any representation.

Q During the audit period, where did that occur?

A During the audit period Northern California would be a good example. I'd say the upper half of California, (p. 196) which would include the entire bay area, San Francisco and the surrounding areas.

Q Would the information that you received from California during the audit period, did that have any effect on the market in the State of Washington?

A Yes.

Q How—what type of effect?

A Our manufacturing competitor probably — our manufacturing competitor would sell — did sell at certain prices within the Northern California area, and those prices determined sales prices in the Washington area for some reason or another. It's a matter of the way you approach the market. It's a national market, as far as our competitors are concerned, and it's a national market so far as we're concerned.

Q Did you have a sales rep in Northern California during the audit period similar to Ashe & Jones?

A Yes. From 1976 — all of 1976, all of 1977. We had no representation in 1978, '79, and the first nine months of 1980.

Q Were you able to maintain your market in Northern California without the sales rep?

A Yes, we maintained our market, and actually we feel our market penetration in that area —

Q Were there any other areas in the United States during (p. 197) the audit period where you had no sales rep?

A Oh, yes. New England, New York, New Jersey, all along the Atlantic Seaboard, Michigan, parts of Ohio, parts of — I'm sorry — parts of Nevada. And, as I said — you said, "any other." I was going to include Northern California, but you did say any other areas.

In the Southeast, which would be Florida, Georgia, Alabama, the Carolinas for a portion of that time. I can't quote you exactly when.

Q Were you able to make sales in these areas without representation during the audit period?

A Yes.

Q And were they — do you have any idea of the volume of sales, say in a particular area, the New York area?

A If I understand the question, in the New York area 100 percent of the sales is without representation.

Q My question was geared to: Would this involve a substantial amount of sales?

Do you have a large market in that area?

A Oh, yes. Of the total Utilities Division sales of the entire country, I would say probably 30 to 40 percent at that time were house account sales, and that is with no sales representation.

Q How would you communicate with these people?

A We communicate directly by telephone, and the mails, of (p. 198) course. But primarily the telephone.

Q Were these the same type of customers as you had in the State of Washington during the audit period?

A Yes. These customers are what we call the waterworks distributors, or wholesale houses.

Q These waterworks distributors, and wholesalers, do they in turn make sales of the products you sell them?

A Yes, they buy our product and pass through it and sell it to the trade in that area. They also buy other waterworks related products. They distribute a complete line of product to do a given job.

For instance, they'll sell to the use, which would be maybe your local waterworks utility pipe, valves, fittings, all type of product that it take to do a complete underground waterworks system. We would only have the pipe. He provides the total package. We're only a part of that package.

It's what we mean when we say "distributor." He buys and distributes product for the waterworks industry.

Q During the audit period did you need to rely on the information provided by Ashe & Jones, or the services provided by Ashe & Jones, in order to make a sale in the State of Washington?

A We received some information from Ashe & Jones, I'm sure, but we could have done without that information. If (p. 199) that's your question, yes, we could have done without the information from Ashe & Jones.

Mr. McKinnon: That is all I have.

The Court: Well, Mr. Meador, let me be sure I understand this.

Do the other divisions of Tyler Pipe need the services of Ashe & Jones, but your particular division does not?

Is your division different from the other divisions?

The Witness: Your Honor, we pursue what we call a waterworks industry, and that is a little bit different from what previous testimony has shown you here. I'm talking about the DWV, or the Soil Pipe Division. They pursue what we call the drain, waste and vent market.

The Court: Yes.

The Witness: It's generally a different set of contractors that do the work and make the installations. It's generally a different set of wholesale houses that buy and resell, or distribute the materials. It's generally under the authority of different people.

For instance, in your city you probably have what we would call a Water Department, which would employ a water superintendent. Under his jurisdiction he would be responsible for delivering clean potable water to (p. 200) your home. He would see that there is a water main installed in the street in front of your house. He would see that that water is by either the city's own facilities, installation facilities, or through a contractor, that you get a meter put in front of your house. He would bring that water and the meter up to the property line.

From there I would say is the division between the waterworks industry and the plumbing industry. From there it would be up to you to hire you a plumber to bring the water on into your house. It would also be up to you to provide your water facilities for your house, which would again tie into the street, and into your local, in many cases, water interceptor.

The waterworks is going to provide you your clean water, and provide — take care of your waste water. By the same token, it comes into your property, back out to the street, or the collection system. That is normally up to you, and normally the plumbing industry brings you the materials it takes to put a water and plumbing system into your home.

In that respect the waterwork industry and the plumbing industry is completely different. The contractors who do the work are different.

The Court: I understand the difference (p. 201) in the products, and functions of those products, but what I'm wondering about is the sale of the products, and why do you consider your division different from the other divisions as far as your sales needs are concerned.

Why is it that you can do without Ashe & Jones, for instance, but the other divisions can't, or are you different in any way?

The Witness: As I have tried to explain to you, we're different in that we're pursuing a little bit different trade, a little bit different industry. Different people do the selling. Different people do the installation. They control what is in your area. The city water department, and what you get in the street, and how that water gets up to the property line.

Your plumbing code tells us what kind of products you're going to use, and the installation procedure you're going to use.

The Court: I understand that. But why is it different to sell the products in the Utilities Division as opposed to the Wade Division products?

Why is it different? Why is the selling process different?

The Witness: Your Honor, I don't have sufficient information to speak for Wade. I'm sorry. (p. 202) I haven't been involved in Wade. I'm really not too familiar with Wade sales, or how they pursue their particular market. But the Utilities Division, as I said to you, our experience over the years has been that we probably, through the years, have had more representation than we do now, as we have changed representation in areas.

Maybe we used a representative to represent the DWV line, but we did not in waterworks. So we have less and less representation all the time in the Utilities Division. It's a matter that we did not feel that we needed that representation in the areas, and our experience has shown that we do not.

I believe you asked the question: Is this true of the other divisions also. As I say about Wade, I cannot — I cannot speak for Wade with enough information, but in the DWV Division I'd say it was very possible we could operate in an area without any representation in a given area.

The State of Washington, I think, is a good example. Many of the wholesale houses that pursue the plumbing industry, the DWV people, those are branches of national organizations wherein sales policies are set elsewhere, and the fact you had that sales rep calling on that particular branch within that given area would not (p. 203) have much to do with whether or not the sale was made. Many of the sales are made at the national level, and that is just the way things work out.

The Court: Yes, I can see that. That would be a difference all right. Let me ask you, Mr. McKinnon, do you have any questions that you would like to follow up on then before Mr. Tuttle begins to examine.

Mr. McKinnon: Well, I just have one question.

Q (By Mr. McKinnon) Are most of your contacts with the wholesalers with whom you deal made on a national, regional, or state level?

A. I'd have to say in most cases they are on a national level.

Q. Why is that, if you can just explain why they would be on a national rather than any other level?

The Court: Well, I can see that the contractors might very well not be local contractors, that they would be bigger projects, and perhaps the contractors would be employed more on a national basis. I can see that.

The Witness: May I comment on that?

The Court: Please go ahead.

The Witness: Why you're saying is very true. You may build a water treatment plant, and your (p. 204) contractor may be from New Jersey.

The Court: Right.

The Witness: The sale of the products that go into that water treatment plant may be made in New Jersey. They may be manufactured in Alabama. And what goes on as far as sales within the State of Washington would have nothing to do with it.

A good example is some of the problems down in the State of Mississippi. They have been having some jobs nowadays that are of such magnitude that they have no contractor large enough to make bond to do those jobs, and the contractors come from out of state, and this causes quite a bit of controversy in the state. The state would like their own contractors to do the work but the job is that large, or the contractor too small they can't do the job.

You're statement is very accurate.

The Court: Anything further?

Mr. McKinnon: Nothing further, Your Honor.

* * *

(p. 208) CROSS EXAMINATION

* * *

Q. (By Mr. Tuttle) Just to make sure I understand your testimony, Mr. Meador, your testimony would be then that those customers that you identified, Pacific Waterworks, Grinnel, H. D. Fowler, Consolidated Supply, Waterworks Supply, and Crane Supply, would have been customers of only the Waterworks Division during the audit period, and not customers of other Tyler Pipe divisions; is that correct?

A. That's correct. We say they are not customers of the other divisions of our company. I would say that by that they are not pursuing the plumbing trade, for instance, or the DWV trade.

Let me turn that around. Well, that would be correct. The waterworks distributor is going here to this particular market, and the DWV distributor's going to his market. And usually there is not much interchange. They might want to buy one stock of pipe, and I'm sure the other divisions would sell them, but, no, they are not customers of the other divisions.

* * *

(p. 224) Q. Okay. Who were your competitors as far as waterworks sales in Washington; competing manufacturers?

A I'm not sure that I know the total picture, but I think you would say goods are sold by Pacific States Castiron Pipe.

Q Excuse me.

A Pacific States Castiron Pipe, Trinity Iron and Steel Company.

Q Excuse me.

A Trinity. U. S. Pipe and Foundry Company.

Q U. S. —

A U. S. Initials "U. S." Possibly American Cast-iron Pipe Company.

Q Excuse me. What was that one more time?

A American Castiron Pipe Company. We have a local producer. (p. 225) I assume he's still producing. Olympic Foundry Company. We have a small foundry in the Los Angeles area called Dayton Foundry Company. We have a specialty waterworks producer, who produces related lines, in Portland, formerly known as Industrial Iron Works. I believe now they operate under the name of Western Foundry Company, in Portland, or the Portland area. And we have some import competition. I think generally that would be the size of it.

Q Do you know whether or not those competitors have sales representatives in the State of Washington?

Mr. McKinnon: I'll object on the ground of relevance. What relevance does that have to the issues at stake here, how they operate?

The Court: Mr. Tuttle.

Mr. Tuttle: Mr. Meador has testified on direct, if I understand his testimony, that it's not really necessary to their sales to have local representatives, that these sales sort of happen magically, and I think it goes very much to the credibility of that testimony whether or not there are competing manufacturers who have representatives.

The Court: Objection overruled. Go ahead, answer the question.

Mr. McKinnon: I'd like one portion of (p. 226) that statement stricken, Your Honor. I think it's a grossly improper categorization when he put in the phrase, "as if they happen magically."

The Court: Overruled. Go ahead.

The Witness: Trinity Valley Iron and Steel does not.

Q (By Mr. Tuttle) Does not have a sales representative?

A Correct. We would consider him our prime competitor in this area. The import people, I'm sure, do not. The local manufacturer, I can't tell you. Dayton Foundry Company does not.

Q Excuse me. Olympic — you're referring to Olympic when you said "the local," right?

A I said I do not know whether he does or not.

Q And Dayton, you said what?

A Dayton Foundry Company does not. And to be frank with you, I don't know about the others. I don't

know of the others having any, but I do not know that they do not.

Q But of these that you have mentioned, you're sure about those; is that correct?

A I'm sure that Trinity Valley does not have a local sales rep. I'm sure that Dayton does not. I'm sure the importers do not. Yes, the ones I have testified to, I'm sure they do not have a local sales representative.

(p. 227) Q Now, when you say they do not have any local representatives, would that include any salesmen employed by the company, as well as independent representatives?

A I'm sure they have sales people who operate in their own producing area. Whether or not those sales people came into this area, I couldn't tell you, if that's your question.

Q But you indicated that you knew about Trinity Valley, and Dayton, and the imports.

Does that mean that they — those that you know about, they did not have factory employed salesmen in Washington?

A My testimony is that — residing in the State of Washington, no. I believe your question is operating in the State of Washington. And if that meant outside sales people coming into the state, I had no knowledge of that.

* * *

(p. 237) Q Is it your practice to seek information from your local representatives before you add a new distributor?

A Yes. If he has information that we might use, I think we would seek that information. I mean, if we felt he had information we could use, yes. There would be occasions where I think in the case of Hines, or comparable to the case of Hines, wherein the information would come elsewhere—come from elsewhere, and the information wouldn't really apply to the area until a later stage, until we pretty much decided what we wanted to do.

I don't think we really consulted Ashe & Jones in the Hines case too much, is what I'm trying to say.

Q Now, you were in Washington in May of '76; is that correct?

A I'm sorry. I can't recall. It was either January or May. I think we have testimony in the deposition which would indicate when we were here.

(p. 238) Q Was one purpose of that trip to look into adding Hines at that time?

A No, I don't think so. At the time I'm sure it was probably just incidental. At the time the Crane Company had a waterworks division in Seattle which they sold, and it would have been a branch of Crane that they sold to the Hines Company, and that occurred in 1976.

But I don't think the purpose of the trip was to discuss whether or not we would sell Hines. I don't believe we gave it any serious consideration at all at the time. The Crane Company branch was not all that important to us.

Q I'd like to call your attention to the—your deposition at Pages 94 and 95, with reference to apparently the May of '76 trip, when you were asked:

"Do you recall any of the subjects that you discussed with John Ashe on that trip?

A I'm sure we discussed the—"

Then Mr. McKinnon interrupted, and he said: "He's asking if you recall what you discussed." And your answer:

"Yes, I recall that we discussed the general market condition; and we discussed the sale of the other customer's waterworks business. And I'm sure we discussed whether or not we (p. 239) would want to sell Hinds Supply Company."

Would that accord with your recollection now?

A Yes, it was, I'm sure, mentioned that the Crane Company was selling out, and they were selling to Hinds Supply Company, but I don't think at all it was the main purpose of our trip. But I'm sure we weren't seriously considering selling Hinds Supply Company.

Q But you did discuss it with the representative at that time, right?

A Probably. My recollection is a little bit shy on 1976.

• • •

(p. 242) Q Again calling your attention to your deposition, the question was asked—

Mr. McKinnon: What page?

Mr. Tuttle: Page 27. Actually let's begin on Page 26 and 27.

"Q What other differences, if any, are there as far as, for example, between the factory salesman and the manufacturer's representatives and how they solicit or take orders?

A I don't quite understand what you mean. In the State of Washington we would not give our independent agent as much support as we give a direct factory man in San Antonio. Distances have something to do with it.

Q In what sense do you mean support? What does that mean?

A Assistance from the office with other sales people to help them. We would look at expense involved, what does (p. 243) it take to support the guy and so forth. But your question originally, I assume, was is there any difference in the way they call on the trade, the way they solicit business.

Q Yes.

A They themselves, sole and alone, I would say very little difference. Each would walk into the customer's place and promote the sale of our products."

Would that be your testimony today as well, as far as the difference in how they call on the trade, and so forth?

A Yes, that would be my testimony.

Q That as far as they act alone, very little difference?

A Yes. I would say when they walk in sole and alone, they promote the goodwill of our customers, and thank them for the business, and see if they can't secure additional business, keep the door open for further transactions.

• • •

(p. 250) Q How does the sales representative go about keeping track of the competition?

A The waterworks distributor has a competitor who is another waterworks distributor. They each bid jobs.

They bid a total package, which would include pipe, valves, fittings, brass, all the products that—all the products required to do an underground water distribution system.

They would put together whatever they want for their particular products, and they bid on a contract to a municipality, or to a private water company, assuming the most responsible low bidder would receive the order.

If the fittings in the bid are broken out, and the competitor can see some way—maybe through a bid to a city, or maybe even a public open bid, if the distributor (p. 251) can see that the prices bid by his competitor were low enough in fact that he thought his competitor was getting a better price from my manufacturing competitor, that information would probably be conveyed to us through the telephone, or to us through our sales representative.

That is what we mean by general market conditions and pricing information.

Q Did you ever have occasions where the sales representative is called upon to handle some sort of an adjustment in a customer's account?

That is, goods arrived, they are non-conforming, of there's a question about the invoice, or something like that.

Does the sales representative become involved in those kinds of matters?

A Oh, we might ship a truck load of material, there would be one item short, and nobody would question the customer, maybe without so noting the shortage on a so-called overage and shortage bill, at the time of delivery. Maybe nobody counted, or miscounted, or something. They might relay to our sales representative they were short one

of this, or one of those. He would relay that information back to us.

Yes, he would be involved like that. Other than that, I don't know of any other situation where he would (p. 252) be involved.

Q So you're saying that is the kind of problem that would arise, that you just described; is that it?

A Well, I think anything which he might be involved in, there may be a more serious problem. Even the shortage itself might not be related to the sales representative. It may be related directly to us through the telephone.

Q Is the sales representative ever involved in investigating a slow pay account, where the customer is not timely paying for the materials?

A I don't recall any sales representative ever handling any problem of this nature for the Utility Division. It may be for other divisions, but I have no knowledge of that. No, I don't think so.

Q You're saying anywhere, or in the State of Washington?

A Well, I'm saying I know definitely that they have never been involved in anything like that for the Utilities Division for the State of Washington, and I'm talking about any sales representative, independent sales representative, has never handled anything like that for the Utilities Division anywhere in the country. Possibly a factory salesman has, but not an independent sales rep.

* * *

(p. 257) Q I believe you testified that you don't maintain any (p. 258) supervisory control over Ashe & Jones; was that your testimony?

A Correct.

Q I don't know what you mean by "supervisory control," but let me ask you this:

Has there ever been an instance where you asked Ashe & Jones to do something and they didn't do it?

A No, I don't recall an instance.

Q So it would be—would it be fair to say that they are usually cooperative and go along with your requests?

A If we had such a request, I think that they would, and I think you could say that they would be cooperative should those occasions arise.

* * *

(p. 263) REDIRECT EXAMINATION

By Mr. McKinnon:

Q Mr. Meador, you testified that you did talk to Mr. Jones (p. 264) during the audit period. Did you discuss anything other than sales in the State of Washington?

A Yes.

Q Can you give us an example. Did you discuss sales in any other areas, or states?

A Yes, we discussed conditions in Montana. We also have a situation wherein we would discuss general market conditions in British Columbia. I would discuss conditions with Ashe & Jones, general market conditions, in Alaska. And also Alberta. He had Edmonton and Calgary.

Q Were you attempting to get into the Canadian market?

A Yes, at that time we were trying seriously to break into the Canadian market. And Mr. Jones and I travelled in Canada several times, and we worked at that quite a bit.

Q You testified that you currently do not have any rep in the State of Oregon. That is just the Utilities Division?

A That is correct.

Q Does the DWR have a rep there now?

A They do.

Q You recall any instance during the audit period when Ashe & Jones rendered any assistance with respect to any complaint made during—concerning a sale of a Utilities Division product?

A No, no complaints, No, I know of no instance.

(p. 265) Q During the audit period, do you recall any instance where Ashe & Jones rendered any assistance, or asked to intervene concerning collection of any particular account?

A No, there were none.

RECROSS EXAMINATION

Q You just testified that there was no instance during the audit period of Ashe & Jones assisting with regard to any complaints, handling of complaints; is that correct?

A That's correct. The waterworks distributor, or wholesaler, were pretty much if he had any complaints would handle those himself.

Q What do you mean by "handle them himself"?

A Well, he sells the trade, and he services the trade. We have nothing to do with that.

Q But if it's a defective product—

A I know of no instance where we have had a defective product. We may have had a broken fitting, it probably been broken at the time it arrived, would never get out to the trade.

Q Who would handle that then?

(p. 266) A Well, the customer, in all likelihood, would call the office and say we received two broken fittings in the shipment last month, you owe me, and we would replace the fitting, or give him credit for the fitting, or the same information he might relay to Ashe & Jones, and they in turn would relay it to us.

Q So with regard to the audit period, is it your testimony you wouldn't necessarily know about a particular complaint?

A No, that is not my testimony.

Q You indicated that there weren't any handled by Ashe & Jones during the audit period, and then you indicated it could have been handled by Ashe & Jones.

A Let me put it this way: There were no serious complaints, no defective product complaints, that occurred during the audit period. And would I have known about any serious complaints, yes, I would have. So my testimony is that there were none.

* * *

REDIRECT EXAMINATION

* * *

Q The inventory you testified to belonging to the waterworks distributors, that is for products after they had been sold by Tyler Pipe?

(p. 267) A I believe the testimony—I believe the question was: Does the waterworks distributor maintain an inventory, and the answer was yes, he does maintain an inventory.

Q But that is his inventory?

A It's his inventory. He buys and pays for it.

Mr. McKinnon: That is all I have.

The Court: I have one question, and it may not be appropriate to you now, but somewhere along the line I would like to have it answered, and that is whether or not the sales of Tyler Pipe products, Utility Division, to the warehousemen, and distributors here in the State of Washington, is taxed in the State of Texas.

The Witness: The Utilities Division products have taxes applied to them.

The Court: I'm just wondering what kind of taxes. If the sales are taxed, not ad valorem taxes, but whether the sales are taxed in the State of Texas.

The Witness: We pay a tax on inventories. We pay a tax on our production machinery. To that degree, yes, utility products are taxed in the State of Texas. We have, of course, our state, county. In addition, we have our school taxes, and we also have a junior college district that we pay considerable taxes to.

(p. 268) DIRECT EXAMINATION

By Mr. McKinnon:

Q State your full name for the record, please, and spell your last name.

A Glenn Jones, J-o-n-e-s.

Q And your residence address?

A 3421 East St. Andrews Way, Seattle, Washington.

Q What is your occupation, Mr. Jones?

(p. 269) A I'm a manufacturer's representative.

Q Do you have a company?

A Yes, Ashe & Jones, Incorporated.

Q Is that a Washington corporation?

A Yes.

Q You hold an office in Ashe & Jones?

A Yes, I'm a director and president of the company.

Q Where does Ashe & Jones maintain its office?

A 971 Thomas Street, Seattle.

Q Can you briefly just tell us what you mean by a manufacturer's rep?

A Well, the name is more or less what it implies. We represent manufacturers in the plumbing and allied fields.

Q You represent manufacturers other than Tyler Pipe?

A Yes, we do.

Q But it would be fair to say that you do not represent other manufacturers on directly competing products?

A No, that would not be—you cannot do that in our type of business. They would be products in the plumbing industry, i.e. sinks, toilet seats, that sort of things.

Q Can you just briefly give us a history of Ashe & Jones, how long it's been in the business?

A Well, it's been in business actually through a predecessor company, James A. Reardon Company, which my father was (p. 270) a principal in, and later it was changed in the late '40's to Earl H. Jones, which was my father's name. Then in about '56 or '57, it was changed to Ashe & Jones. But it has a history going back to about 1926, or somewhere in there.

Q Okay. When did the corporation, or its predecessor corporation, commence to represent Tyler Pipe?

A I was in the service at the time, but I think it was about '44, '45. In that time frame.

Q Which divisions of Tyler Pipe do you represent?

A We represent the Utilities and the DWV.

Q Now, there's been testimony that you provide Tyler Pipe with market information.

Can you just briefly relate the process you go through in providing them with that type of information?

A Well, we're calling on ongoing jobbers, and through our contacts over the many years we're familiar with most of the principals in the business. And if there is a market condition, a competitive condition, we would be informed and so inform the foundry.

Q Do you represent Tyler Pipe in areas other than just the State of Washington?

A Yes, we do.

Q Can you briefly tell us what the other areas are?

A We have northern Idaho above Lewiston, the State of (p. 271) Montana, the three western provinces of Canada; Saskatchewan, Alberta, and British Columbia, and the State of Alaska.

Q Do you take any orders on behalf of Tyler Pipe for either of the two divisions that you represent?

A Yes, we receive orders.

Q What do you do with the orders when you receive them?

A In the normal course of business, we would, and today, we usually phone them to the respective division of Tyler.

Q Do you recall, during the audit period—and you understand what the audit period is in this case—have any instance where you took any action with respect to any complaints on any sales of Tyler products?

A In that time frame, I can't recall of any specific instance, no.

Q Have you—does it ever happen that you might do something like this?

A Yes, I think maybe it happened, but it's so infrequent that we have a quality product, and I stretch myself to really think about it in the time frame.

Q During the audit period, you recall any instance where you took any action in order to assist Tyler Pipe in collecting a delinquent account?

A No, I do not.

(p. 272) Q Do you maintain any inventory for Tyler Pipe in the State of Washington?

A None whatsoever.

Q Do you conduct any advertising for Tyler Pipe in the State of Washington?

A No.

Q Now, there are certain instances where sales are called in directly to Tyler at its offices in the State of Texas.

A That's correct.

Q Do you receive a commission on those sales?

A Oh, yes.

Q Do you receive a commission on any sale to a customer in the State of Washington?

A We're the sole representative of those two divisions in the state.

Q What type of information does Tyler Pipe provide you?

A Well, basically with the catalog information, and the discount structure to go with the catalog information.

Q Okay. Anything else that you can think of?

A Well, if there's a new product, we would get brochures, or a bulletin that would be sent to the jobbers and ourselves regarding a new item.

Q Do you recall, during the audit period, receiving any such information with respect to a new item?

(p. 273) A Not in that period, no, sir.

Q Did you ever receive any payment for any of the products that were sold by Tyler Pipe?

When I say "you," does Ashe & Jones receive payment?

A Oh, pardon me. You mean do they pay us?

Q Yes.

A No, sir. It would all go directly to—well, I think on their invoice they have bot a box, I believe, in Dallas, or Tyler. I'm not familiar with that. But it would never come through our hands.

Q Do you pay Washington B & O taxes on the commission that you receive from Tyler Pipe?

A I certainly do.

* * *

CROSS EXAMINATION

* * *

Q With regard to that last point, you pay B & O on commissions that you receive; was that your testimony?

A That is correct.

Q So you don't pay on the gross amount of the sale, just on the commission that you receive?

A There would be no way we could—we're not required to report that way. It would be very hard to report that (p. 274) way anyhow. We report commission from all individuals, the way the tax laws read for the state, I believe.

* * *

(p. 279)

CROSS EXAMINATION

* * *

Q Do you ever give him—okay. How about Mr. Meador; why would you be talking to him?

(p. 280) A It would be market conditions in the Utilities Division. And it might—might have to do with areas other than the State of Washington. We have had numerous conversations about Canada, as testified, and other areas. We have discussed Oregon. We have discussed Alaska, at times, market conditions.

Q And Mr. Horan, what would you be calling him about?

A That relationship goes back a long ways. Sometimes it's information, gossip, things going on, people moving around, customers selling out to conglomerates. He's in charge of the exports. I do refer to him on Canadian business. That is his department. He's the export end of the DWV.

Q Oh, in addition to the other divisions, he oversees export sales; is that what you're saying?

A That is correct.

Q And why would you be talking to Mr. Gerhardstein?

A In regards to Soil Pipe market conditions in the United States.

Q Would you ever be talking to Horan, Meador, Gerhardstein, or VanDerbeck, about specific orders; would you have been?

A In the time frame of the audit period, I can't think of ever talking to them about a specific order, no.

Q So it would have been primarily market information; is (p. 281) that correct?

A Right.

* * *

Q You have testified that you were a representative for other companies besides Tyler Pipe; correct?

A That is correct.

Q How many such companies, can you say?

(p. 282) A Offhand, about five, six other manufacturers.

Q And they would have been in non—they would have carried products that were not competitive with Tyler's then; is that right?

A That is correct.

Q Do you—when an order is filled, do you receive a copy of the invoice?

A Yes.

The Court: Was that true even though the order was placed directly by the customer to Tyler Pipe?

The Witness: Yes. We would always receive a copy of every invoice coming in the state.

* * *

(p. 283) Q Okay. Let me rephrase. Start with the Soil Pipe Division.

Did you provide them with information about what the market prices were with soil pipe products?

A Yes.

Q And would they then use that information in establishing their prices for Washington?

A In conjunction with other information, yes.

Q How about the Utilities side, would you provide them with market price information there, too?

A Yes. But in that situation there are less competitors in that field, and it isn't as volatile as, say, the soil pipe sales.

Q So you're saying that changes in prices were less frequent?

A Yes.

Q But ultimately, in all cases, Tyler Pipe set the prices that it would charge to its customers; is that correct?

A That is correct.

* * *

(p. 285) Q How many employees does Ashe & Jones have?

A Counting myself, we have four full time and one part time.

Q And how many of those are sales people then?

A Three and a half.

Q By "sales people" then, are these three and a half people going out and calling on customers; is that correct?

A That is correct.

* * *

(p. 287) Q What do you do on Tyler Pipe's behalf? Can you characterize generally what activities you engage in in the Washington market?

A Well, No. 1, as I said before, we keep them abreast of market conditions. If a new product was to come out, we would try to get to the specifying architects, or engineers—mechanical engineers.

Q Would you explain that, if a new product were to come out?

A We would try to get to the people that specify the use of that material for buildings, i.e. like this courthouse, or Columbia Center, or whatever it is, to make sure this product was at least approved or in their specifications. We might call on contractors to promote the use of our material on a specific job and/or jobs.

Q So when you say, get to the engineers to get them to specify, that would be to specify soil pipe—Tyler soil pipe products?

A Yes. Or if there was a new item in the utilities, it was a specification item, we would do the same with that, (p. 288) of course.

* * *

Q How much of your time would you say is devoted to contacts like that with engineers and architects?

A It varies. Maybe 20 percent, 25 percent.

Q Could it be a third?

A Could be, at times. That is just a guestimate. It's (p. 289) very hard.

* * *

Q Okay. So for what purpose would you be calling on contractors then again?

A To get them to use our product.

Q Do you have well-established relations with most of the architects and engineers in the trade—in the business?

A I would say yes. I have been in it all my adult life.

Q Would the same also be go~~o~~ relations with contractors in the field then as well?

(p. 290) A Yes.

* * *

(p. 292) Q Do you solicit orders from wholesalers?

(p. 293) A Yes.

* * *

(p. 297) Q You indicated about once a year. The question was:

"How often would you say that has happened?

A Infrequently. Maybe once a year."

A What I think, Mr. Tuttle, I might have been referring to, is an invoice that was not paid. Usually it's an oversight often in a chain outfit, where they overlook an invoice. It isn't slow pay, per se. It might be a specific invoice that somehow was not paid, and we might help them clarify that.

Q So you would be involved in that situation?

A Rarely, yes.

* * *

(p. 298) Q I don't mean to use "investigation" in a technical sense, just looking into a competing product in the market.

A Are you saying look into a competitor's activities? Is that what you're referring to?

Q Yes.

A We wouldn't be asked, but we would do it on our own.

* * *

(p. 302) Q Now, if a customer had a complaint about a Tyler Pipe product, would it contact you ordinarily?

A Either way. Could contact us, or could contact the (p. 303) foundry.

Q Would one course be more common than the other, was it, during the audit period?

A We don't have that many problems. I couldn't say. What would be the problem, quality?

Q Non-conforming product, not enough shipped. Any kind of problem.

A In thirty years I could name on one hand.

Q In thirty years there have been less than five times?

A Quality problems, yes.

Q How about insufficient quantity shipped?

A They might contact us. They might contact the factory. I thought you were talking about quality problems. You're talking—

Q I'm talking either one.

A Oh, that does happen. Human beings ship things, and a lot of times they would contact us about that, certainly.

Q So as far as an insufficient quantity being shipped, would it be more common that they would contact you, the customers contact you?

A In the Soil Division, I'd say yes. In the Utilities, either way.

Q How often does that—did that happen during the audit period, would you say, that there was either a non-conforming product, or an insufficient quantity shipped?

(p. 304) A Boy, it would be a wild guess. I couldn't—I mean, it would just be a wild guess. 50 times. I don't know. It would be a wild guess.

Q During the audit period?

A Yes. I would say maybe 10, 12 times a year.

Q And that was—you're saying that is the number of times that you were contacted; is that correct?

A We were contacted, yes. That is a guess, as I say, of course.

Q If you were contacted then, Ashe & Jones, what would you have done—what did you do?

A We would report it to the foundry.

Q Would you make some investigation?

A Not necessarily.

Q If one—if any investigation were required, would it be you that did it, Ashe & Jones?

A Probably, yes. Let me put it this way: If a customer says they got two inch fittings for three inch fittings, we take their word for it, and the foundry would take our word.

Q So in that kind of situation you're acting on behalf—is it correct to say that you're acting on behalf of Tyler in dealing with the customer?

A No, we would go back to the foundry. They would be the ones that would have to decide what to do.

(p. 305) Q But you're not acting for the customer, you're acting for Tyler; is that correct?

A No, we would be acting for Ashe & Jones, and reporting to the foundry.

Q Whatever Tyler told you to do in a situation like that, you would do it; is that correct?

A Yes, they set policy.

* * *

(p. 314) Q Now, I believe you indicated that you have three and a half sales people working for you, including yourself; is that correct?

A That is correct.

(p. 315) Q Can you give me an idea of how often, on an average during the audit period, each of these customers would have been called on by somebody from your company?

A That would vary with the location. Some of them weekly. Some may be monthly, or every other month.

Q Depending on how close they are to Seattle?

A Yes.

Q Are most of them close to Seattle?

A No. About half of those would be in western Washington, roughly.

Q So you're saying that someone from your company would call from—would call on each of these customers on an average of weekly, if they are in western Washington, or monthly?

A That would be a close approximation, yes.

Q Now, you also indicated that you call on engineers, and contractors, and architects; is that correct?

A That is correct.

Q Can you give an approximation of how often they would be called on?

A No.

Q Taking, say, engineers. Are there some that you call on more often than others?

A Yes. The ones that are doing more work would be called on more often, yes.

(p. 316) Q Can you give me a couple of examples of those?

A Names?

Q Uh-huh.

A The firm name, you mean, like—

Q Please.

A Boullion's firm, Dick Stern, Valentine & Fisher.

Q And how often would you say each of those would have been called on during the audit period by someone from your firm?

A Once every six months, perhaps.

May I establish something?

THE COURT: Just respond to questions.

Q (By Mr. Tuttle) How about—can you give me some—who would you call on as far as contractors?

Can you give me some examples?

A Well, there would be Botting.

Q Pardon?

A Botting, B-o-t-t-i-n-g, Warren, Little & Lund.

Q Pardon?

A Warren, Little & Lund. Three names. Gale Mechanical, G-a-l-e, University Mechanical.

Q How often would you call on those, as examples?

A Two or three times a year. Perhaps more on some of the larger ones.

Q Is that pattern fairly typical then of the contractors (p. 317) that you would call on two or three times a year?

A That would be hard to say typical. If they had bid a job, or something, you might call on them a half dozen times in a short time frame. There isn't any typical pattern for that type of call.

Q Would the same be true then for the engineers?

A Yes.

Q Could be more, could be less?

A Yes.

Q Do you view those calls as being important to continuing your relationship with those—that is Tyler's relationship with those engineers and contractors?

A Well, we're not calling on them solely for Tyler. We represent other people.

Q Are those—but my question is: Are those calls important to maintaining Tyler's relationships with them?

A To some extent, yes.

* * *

(p. 321) Q (By Mr. Tuttle) Do you think, Mr. Jones, that during the audit period Ashe & Jones was effective in maintaining good relations for Tyler in the State of Washington?

A Yes.

* * *

(p. 327) Q So as long as you're their representative you get commissions on utility sales regardless of what you do; is that right?

A In the agency business you get commissions on any sales made in your territory from any principal.

Q So it's—why is that? Why is that done? Why should Tyler pay if you didn't make the sale?

A That is not only true of Tyler, that is true of everybody we represent.

Q My question is why.

A Because you're their agent. You receive a commission on what is sold in your territory.

Q You're saying it's the nature of the business, in effect?

A Yes.

* * *

(p. 328) REDIRECT EXAMINATION

By Mr. McKinnon:

Q I'm handing you what has been admitted as Exhibit 20, Mr. Jones, and calling your attention to the third page (p. 329) of that exhibit, which lists the commissions paid Ashe & Jones during the audit period, and I would ask you: Do those commissions paid, as reflected on Exhibit 20, include sales made outside the State of Washington, to your knowledge?

A To my knowledge those would have been out total commissions for our whole territory.

Q That would include sales in Canada?

A Montana.

Q Alaska?

A Yes.

Mr. Tuttle: Counsel, could I see what you're referring to.

Mr. McKinnon: Sure. Exhibit 20.

Q (By Mr. McKinnon) Mr. Jones, do you receive any guidelines from Tyler as to how to conduct the business of Ashe & Jones?

A None whatsoever.

Q Have they ever set any requirements on Ashe & Jones as to how to conduct its business?

A No, never.

Q Have they ever audited the business of Ashe & Jones?

A Never.

Q There was some testimony yesterday with reference that you might quote a sink, or a speciality type product.

(p. 330) For whom would you do that?

A The question was, did we quote. I said, "Yes." But a sink would be another manufacturer. We represent an outfit that is called Alkay Manufacturing that makes sinks. I think I mentioned toilet seats, and we represent an outfit that makes toilet seats, Mr. McKinnon.

Q Does that have anything to do with Tyler?

A None whatsoever.

* * *

(p. 332) DIRECT EXAMINATION

By Mr. Tuttle:

Q Could you state your full name, and business and home addresses, for the record, please?

A Yes. Ronald E. Fahey, 20625 Maplewood Drive, Edmonds, Washington, 98025. Business address is 1016 First Avenue South, Seattle, 98134.

Q How are you employed?

A I'm an independent representative—manufacturers representative.

Q Are you with a particular firm?

A Yes, Mechanical Agents, Incorporated.

Q That address, 1016 First Avenue South, is the address for Mechanical Agents then?

A Yes.

* * *

(p. 343) Q (By Mr. Tuttle) Do you talk to—I assume that you are on a regular basis soliciting orders for Wade; is that correct?

A Yes.

Q In doing so, do you ever have occasion to refer to non-Wade Tyler products?

A No.

Q Is there any advantage—do you ever—you're saying you never refer to a non-Wade Tyler product at all with a customer?

A No.

Q Would the fact that shipments of both Wade and non-Wade Tyler products are made together, would that benefit the customer in any way?

A No.

Q It wouldn't get the product there sooner to him, or products together when he needs both kinds, or anything like that?

A No.

Q Why is that?

A Because orders are shipped from our inventory. We place orders for stock replacement with the factory for shipment to our warehouse. We have got pretty good

* * *

(p. 345) Q Do you ever handle any—have you ever had any non-Wade Tyler products come through your warehouse?

A No. Excuse me. Other than other manufacturers' product that we represent.

Q I said, "non-Wade Tyler products." Other Tyler products from other than from the Wade Division.

A No.

Q Who sets the prices for the Wade products?

A Wade.

Q The prices to the customers?

A Wade.

Q Is that entirely their decision then?

A Yes.

Q Do you provide information about the market to assist them in setting those prices?

A Yes.

EXCERPTS OF DEPOSITION
OF JAMES B. HORAN

* * *

(p. 4) Q (By Mr. Tuttle) Mr. Horan, do you utilize the services of the local sales representative in Washington if direct contact from Tyler, Texas doesn't get results from a slow paying customer?

A My reply, I think, was "sometimes."

Q When you—I believe your testimony was that sometimes you—the sales representative would make that contact initially, but then I was inquiring about the situation where the initial contact had been made from Tyler, and has not been fruitful.

Then what happens? Is the sales representative contacted?

A Sometimes.

* * *

(p. 7) Q Do you have knowledge of Tyler's practice with regard to following up on accounts, or collecting accounts, where there has not been yet payment?

Do you have knowledge of that?

A In the broad sense, yes.

Q Again, then my question is: With reference to customers, who are headquartered in Washington, where the initial contact from Tyler, Texas, about nonpayment has not been successful, what are the options available, and customerily followed by Tyler, as far as collecting that account?

A Generally speaking, there are other steps that can be taken by the credit department, without calling on our local representation, to assist us in collecting that debt. Now, one, we advise the customer that no further shipments can be made until such time as the account clears, or an agreement is reached as to when the next check will be written and can be cashed by Tyler Pipe. This does not require the local representative.

Q That would be a contact directly from Tyler?

A That is usually direct contact by a known officer in our credit department.

(p. 8) Q I'm interested in what options are available other than direct from Tyler, Texas, or through the local representative.

A Other than that? Well, if it comes to the worse, then you call upon the credit association, to which we are members, and put that company on file with the credit association, and the credit association then seeks collection.

Q Before that is done, would the local representative be contacted?

A At some point perhaps, yes.

Q You say, "perhaps." Would the local representative be contacted as a matter of course before the credit association became involved?

A Once again, Mr. Tuttle, it might depend on the long term and ongoing relationship with that particular customer. If his tradition and habit has been slow pay,

it might come to pass that it is our decision, made at headquarters, to terminate the relationship with that customer, without, once again, calling into play our local representation.

Q Would it be the usual practice to have the local sales representative become involved if contacts from Tyler, Texas were not successful?

Mr. McKinnon: Objection. That's been (p. 9) asked and answered.

Mr. Tuttle: No, he hasn't answered whether or not that is the usual practice.

Mr. McKinnon: He most certainly has. He said sometimes they might do it.

Mr. Tuttle: "Sometimes" does not answer whether or not it's usual, as opposed to being the exception.

Mr. McKinnon: Go ahead and answer it.

The Witness: No, it's not usual.

Q (By Mr. Tuttle) It's not usual?

A It's not usual.

Q To involve the sales representative.

A No, sir. And may I expand on that?

Mr. McKinnon: Go ahead.

The Witness: The collection of debts is an onerous event in any case, and it should not be the function of local representation to make that an extremely important part of his responsibility to Tyler Pipe. Therefore, Tyler Pipe has established a credit department of sufficient size, and

expertise, to take on that function directly from Tyler, Texas. In all departments, that is our responsibility at Tyler, Texas, to collect the money due us from customers, whoever they might be.

(p. 10) Q (By Mr. Tuttle) Is it the usual practice to involve the local representative before the account is referred for collection by an outside agency?

Mr. McKinnon: Objection. The usual practice is not in issue here. What is in issue is what occurred in Washington during the audit period.

If you can answer, go ahead.

The Witness: Under that framework, I don't know.

Q (By Mr. Tuttle) What do you mean? Under what framework?

A The audit period in the State of Washington. I cannot identify specifics. So my answer would have to be: sometimes.

Q Counsel may have his objection, but I'm wanting to know what—not just in Washington, but during the audit period, what Tyler relies on its sales representatives to do. So I'm asking for your general practice, and I'm saying my question is this:

Was it Tyler's usual practice to involve the local sales representatives in trying to get a payment made from a slow paying customer before that account is referred for collection to an outside agency?

Mr. McKinnon: Objection. It's been asked and answered. Go ahead. You can answer.

(p. 11) The Witness: Once again, I would say: sometimes.

Q (By Mr. Tuttle) More often than not?

Mr. McKinnon: Objection. That is argumentative.

Mr. Tuttle: Counsel, I don't see how it's argumentative to try—

Mr. McKinnon: That's fine. I'm noting my objection on the record. He can go ahead and answer. It will be handled by the Judge. No sense in engaging in colloquy over that.

The Witness: More often than not? Well, I'm going to say yes for the sake—all right, yes.

Q (By Mr. Tuttle) Does Tyler sometimes have changes in the identities of the wholesalers with whom it does business?

A I don't understand that question.

Q Do the wholesalers change?

A You mean the company sells to someone else? It that what you're—

Q No. Do you lose some wholesalers, and get some new ones?

Mr. McKinnon: The question, Mr. Horan, is geared to the State of Washington during the audit period. If you have personal knowledge of any changes (p. 12) during that period.

The Witness: I do not have such knowledge.

Q (By Mr. Tuttle) I want to ask: During the audit period, but outside the State of Washington, did you have chains in wholesalers?

Mr. McKinnon: We're reserving objections. That is clearly irrelevant.

The Witness: I would have to say due to our national activity the answer must be: Yes.

Q (By Mr. Tuttle) When you add a new wholesaler, start doing business with a new wholesaler, do you do an investigation of some kind of that wholesaler?

Mr. McKinnon: Are you talking about someone outside the State of Washington during the audit period?

Mr. Tuttle: Yes.

Mr. McKinnon: Continuing objection.

The Witness: Yes.

Q (By Mr. Tuttle) Who conducts that investigation?

A It's conducted principally by us, since the final determination to accept that customer as a customer is also determined by us.

Q You say primarily by you. Who else would be involved in the investigation?

(p. 13) A Well, the local representation might be involved. Once again, Counsel, this could come from a chain supply house opening a new place of business in the marketplace that we may or may not choose to solicit his business. The local representation would have no responsibility for that whatsoever. That would all accrue to headquarters.

Q In the situation of a chain, you're saying?

A Perhaps a chain, yes. That is an example. It makes my answer cloudy in that respect.

Q I understand that. Assuming it was not a chain, or—assuming it was not a chain, would you ordinarily look to the sales representative for information about the wholesaler before taking it on as a new customer?

Mr. McKinnon: Objection to the form. It assumes facts not in evidence, and a proper foundation has not been laid.

If you can answer, go ahead.

The Witness: In some sense, yes. That is, where is the company located, the size of the billing. But then, once again, it relies on us at the headquarters to examine the profile of that customer. It's financial statement presented to us, and so forth.

Q (By Mr. Tuttle) Yes, I understand what happens, that there is obviously some investigation at headquarters. (p. 14) I'm trying to find out what you look at the sales representative to find out for you about a new customer.

A Who, what, when, and where answers.

Q So it's a lot—

A Who is it, what are they doing, where is the business located, and so forth.

* * *

EXCERPTS OF DEPOSITION OF
WARREN VanDERBECK

* * *

(p. 4) Q Could you describe your position as regional sales manager? What does that responsibility entail?

A The promotion of Tyler products in the area that I have control of, or oversee.

Q Then you have people who report to you for that purpose; is that right?

A Yes. I have some factory people and then I have some representatives that just represent us.

* * *

(p. 6) Q I'm wondering what the differences are between the factory sales people, I guess you call them, and the manufacturer's agents or representatives, those two groups. And the only thing I've heard so far is, it sounds like the manufacturer's representatives can represent a number of—

A Right.

Q Whereas the manufacturer's or the factory sales people represent just Tyler?

A Just Tyler, right.

Q Are there any other differences between those two classifications?

A I guess there is a difference in the rate of commissions, but that would probably be the only thing that I could recall.

Q Is there one category that is higher than the other?

A Yes. Uh huh.

Q Which is higher?

A The manufacturer's reps would be on a little higher commission rate.

Q Do the factory sales people—am I using the right terminology, is that what you call them?

A Factory sales people, yes.

(p. 7) Q Do they get any benefits from the company or anything like that, any insurance or—

A They are in the insurance program, yes.

Q And the manufacturer's representatives do not get insurance, then?

A They are independent businessmen, right.

Q So that would be another difference, then, between them?

A Uh huh.

Q Any other differences that come to mind?

A Not that come to mind, no.

Q Does either of the classes have office space provided, say, by the company?

A No.

Q Either receive a car to use or anything like that?

A No.

Q But other than the insurance, then, you are saying that both of them are strictly on commission?

A Right.

* * *

(p. 11) Q Well, let's come back to that. Does the process by which a sale is made to a customer vary as between the (p. 12) factory sales people and the sales representatives?

A I would say no.

* * *

(p. 55) Q You also receive information back from these people, outside sales people, or the representatives; is that right?

A Yes, uh huh.

Q Are they pretty much your source of information as far as the market conditions in their areas?

A Pretty much, yes.

Q And so they, on a routine or regular basis, provide you with that kind of information? That is, what the market is like in their area?

A Well, whenever the market would change, uh huh.

Q Is that just a sort of—

A Nothing on a routine type of—

Q Is that just sort of understood that that is—or expressly stated that that is one of their functions?

A Well, they provide us with that information, they (p. 56) think that we need to know it, so—

Q Do you have any other source for that information?

A Not really, no.

* * *

(p. 62) Q Oh. By the time the representative phones in the order, has he first initiated a check on the customer; is that right?

A No, not necessarily. He makes the decision whether he wants to sell that customer, and then he gets the customer to fill the credit application, which is forwarded to Tyler, and then the Credit Department either says yea or nay.

Q And so that precedes the order, or—

A A new order, yes.

Q From a new customer?

A Uh huh.

Q Let me make sure I understand. The sales representative would say to the new customer, "We have got to get your checked out before we can process your order," is that basically it?

A Well, he has them fill out a credit application, right.

Q Okay. So the credit application, then, is sent (p. 63) from the representative to the Credit Department in Texas?

A Right.

Q Is checked out?

A Right.

Q Then comes back yea or nay?

A Right.

Q And then the order can be sent in.

* * *

(p. 77) Q Now, again, just by way of summary, we have gone through most aspects of the sales transactions. Does this recall to your mind any differences between the factory sales people or the so-called independent or manufacturer's representatives?

(p. 78) A No.

Q As far as the way they operate or anything else?

A None that I can—

Q Other than what you have already listed?

Mr. McKinnon: I'm going to note an objection on the record as to the form of that question.

By Mr. Tuttle:

Q I believe you previously indicated a couple of differences, that is, that the factory sales representatives, you didn't know of any that had written contracts, for example, were as you thought some of the representatives did. Okay. That would be one difference, right?

A Yes.

Q And the factory sales people had some insurance benefits, maybe, that the manufacturer's representatives didn't personally, is that right?

A Right.

Q And I believe you also indicated that in general, the factory sales people probably covered the areas where the territories where Tyler had a little bigger market share; is that right?

A Well, close to home, right.

Q Close to home. Okay. Are there any differences other than those, as far as you are concerned, between the operations of the sales persons, factory sales people, as (p. 79) opposed to the manufacturer's representatives?

A None that I can think of.

* * *

DEFENDANT'S EXHIBIT NO. 4

INTERROGATORY NO. 4: For each department, division, and/or geographic or functional subdivision identified in the preceding answer, please state:

(a) Its function or purpose, including any changes therein, during the audit period;

(b) The location of its headquarters, its principal place of business, and the region it served, including any changes, during the audit period;

(c) If you have not already done so, the organizational structure of its management personnel during the audit period, identifying them (as defined above), including any changes.

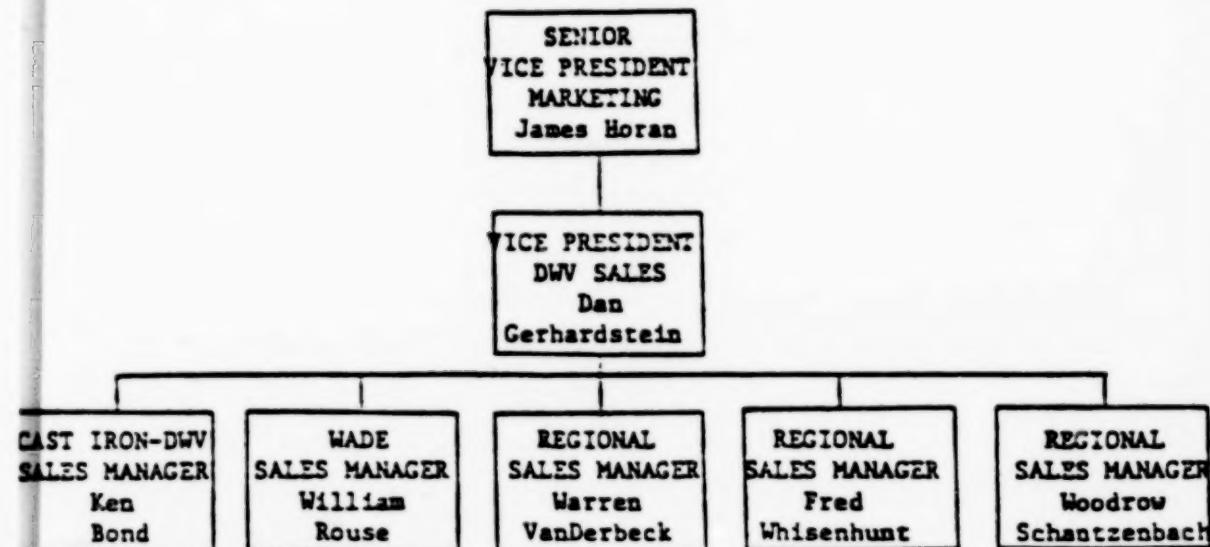
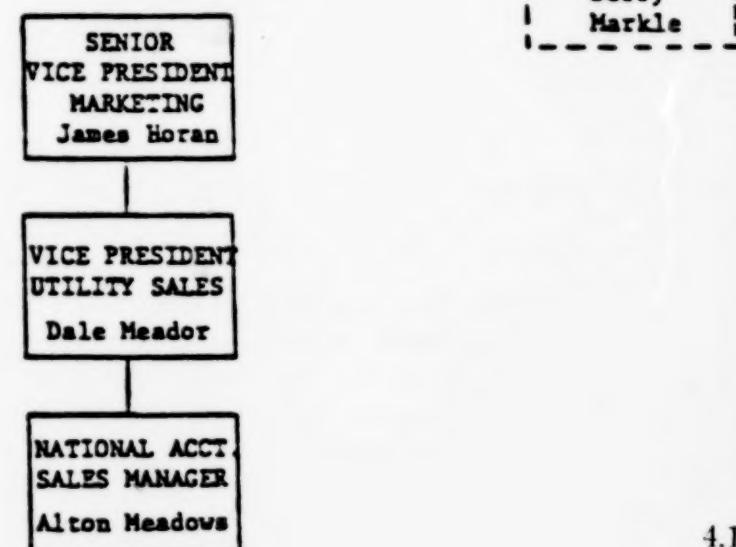
ANSWER:

All of the individuals named in the attached organizational charts numbered 4.1, 4.2, 4.3, and 4.4 are employees of Tyler Pipe Industries of Texas, Inc. All except Mr. Markle and Mr. Schantzenbach make their home and work in Tyler, Texas. Mr. Markle, who left the company in 1981, lived in Orefield, Pennsylvania and worked in Macungie, Pennsylvania. Mr. Schantzenbach, who replaced Mr. Markle, lives and works in Macungie.

ATTACHMENT TO INTERROGATORY NO. 4

TYLER PIPE INDUSTRIES, INC.
MARKETING DIVISION

- (a) Function—Receive and process customer orders.
- (b) Location of headquarters—Tyler, Texas.
 - * Principal place of business—Tyler, Texas.
 - * Region served—USA.
- (c) Organizational structure of management personnel:

DWV SALES DEPARTMENTUTILITY SALES DEPARTMENT

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DEFENDANT'S EXHIBIT NO. 5

INTERROGATORY NO. 4-2: State, describe and explain:

- (a) The respective functions of the DWV Sales and Utility Sales departments in the Marketing Division, including but not limited to the ways in which their respective functions are different and the ways in which they are coordinated or similar;
- (b) What, if anything, the initials "DWV" for the DWV Sales Department stand for or signify;

• • •

- (d) The respective functions and duties of your Vice President DWV Sales, Cast Iron-DWV Sales Manager, Wade Sales Manager, Regional Sales Manager Warren VanDerbeck, Vice President Utility Sales, and National Acct. Sales Manager

• • •

* * *

See attached. Description of Duties is from the Job Descriptions.

ANSWER:

- (A.) The products sold by the Utility Sales department reach the market generally through wholesale "waterworks" distributors, whose customers are "utility" contractors, cities, etc. Utility Sales may or may not, use the same sales representatives as the DWV Sales department. The products sold by the DWV Sales department reach the market generally through wholesale plumbing supply distributors, whose customers are "mechanical" and/or "plumbing" contractors. It is the general function for both to accept and fill orders,

and generate and maintain files on the appropriate paperwork pertaining to those orders.

- (B.) The initials DWV signify drainage, waste, and vent (piping systems).

* * *

(D.) *Vice President DWV Sales*

FUNCTION:

Under general direction of the Senior Vice President of Marketing, directs all activities pertaining to the DWV Sales Division such as the pricing, promotion and sale of DWV Products and all administrative policies of the Company as related to DWV Division Sales.

DUTIES:

* * *

- 2. Directs, supervises, evaluates and oversees the performance of Field Sales Representatives on the sale and promotion of all DWV Products and/or revisions in products. Assists Field Representatives in handling customer problems. Reviews and approves DWV Sales monthly commission statements for all Field Representatives. Makes recommendations to Senior Vice President of Marketing on the hiring of new Representatives as vacancies occur.

* * *

(D.) *Regional Sales Manager—Warren Van Derbeck*

FUNCTION:

Under general direction of the Vice President—DWV Sales, performs a combination of selling and promotion duties pertaining to Wade products.

DUTIES:

1. Responsible for coordinating and visiting with sales representatives as assigned so as to keep representatives up-to-date on all phases of Wade product sales and engineering which involves giving instructions on the complete line of Wade products, job take-offs, working from plans and specifications, and the proper method of preparing and pricing quotations and with special emphasis being placed on carrier and shokstop layouts.

2. Assists representatives with calls on mechanical contractors and engineers so as to best serve the mechanical contractors with project layouts and installations and with service to mechanical engineers in an effort to secure Wade specifications. Also assists at job sites with various installation problems, etc.

* * *

4. Responsible for various other duties such as assisting with the planning and preparation of sales meetings; may help prepare specification catalogs and price lists; assist representatives with the closing of orders as necessary; trains representatives on the value of new products with emphasis on proper usage and specifications of same.

* * *

(D) Vice President—Utility Sales

FUNCTION:

Under general direction of the Senior Vice President of Marketing, directs all activities pertaining to the Utility Sales Division such as the pricing, promotion and sale of Utility Products and all administrative policies of the Company as related to Utility Division Sales.

DUTIES:

* * *

2. Directs, supervises, evaluates and oversees the performance of Field Sales Representatives on the sale and promotion of all Utility products. Responsible for the proper indoctrination and training of Field Representatives on new Utility Products and/or revisions in products. Assists Field Representatives in handling customer problems. Reviews and approves Utility Sales monthly commission statements for all Field Representatives. Makes recommendations to Vice President of Marketing on the hiring of new Representatives as vacancies occur.

* * *

DEFENDANT'S EXHIBIT NO. 9

INTERROGATORY NO. 8-2: State, describe and explain:

- (a) How the functions of Tyler Pipe Industries of Texas, Inc. relate to those of your other subsidiaries;

* * *

ANSWER:

- (A) Tyler Pipe Industries of Texas, Inc. produces all cast iron and pressure pipe and fittings and specification drainage castings sold and distributed by Tyler Pipe Industries, Inc. (Delaware).
- (B) Cast iron and pressure pipe and fittings sold in Washington were manufactured by Tyler Pipe Industries of Texas, Inc. Tyler Plastics Company produced plastic pipe and fittings which were sold in Washington.
- (C) Tyler Pipe Industries, Inc. (Delaware) handles sales and distribution of products manufactured by Tyler Pipe Industries of Texas, Inc. and Tyler Plastics Company.

DEFENDANT'S EXHIBIT NO. 13

INTERROGATORY NO. 12: Identity, as defined above, each employee, agent, independent contractor, or other individual who was compensated or paid in any way by Tyler Pipe or any subsidiary and either resided, was physically present, or carried on any activity in Washington at any time during the audit period.

ANSWER:

1. Ashe & Jones, Inc.
2. Bridgeport Sales, Ltd. (Formerly J. G. Beard Co.)
3. Mechanical Agents, Inc.
4. Warren VanDerbeck
5. Manley Hendricks
6. Dan Gerhardstein
7. Dale Meador
8. Alton Meadows

DEFENDANT'S EXHIBIT NO. 15

INTERROGATORY NO. 13: For each individual identified in the answer to Interrogatory No. 12, describe all his or her Washington contracts (residence, presence, activities, etc.) during the audit period, including the dates thereof. Also, identify every document now or ever in your possession (or the possession of any subsidiary) pertaining to each such contract.

ANSWER:

The three companies (1, 2 & 3 under #12 above) handle all sales functions pertaining to our products. The balance of the personnel are located in Tyler, Texas and maintain liaison between Tyler Pipe and its subsidiaries and the independent representatives.

DEFENDANT'S EXHIBIT NO. 16

INTERROGATORY NO. 18: Identify each sales representative of Tyler Pipe (or any subsidiary) which was present in Washington at any time during the audit period.

ANSWER:

See numbers 1, 2 & 3 under #12.

DEFENDANT'S EXHIBIT NO. 17

INTERROGATORY NO. 20: For each sales representative identified in the answer to Interrogatory No. 18, state the total dollar volume of Washington sales in which it was involved in any way on behalf of Tyler Pipe or any subsidiary during each year of the audit period. If any Washington sales were made or entered into by Tyler Pipe or any subsidiary directly (without involvement of a sales representative), separately state the total dollar volume of such direct sales during each year of the audit period. If the total of the answers to the preceding two sentences, *i.e.*, sales through sales representatives plus direct sales, does not constitute the total of all sales in Washington customers during the audit period, explain the difference.

ANSWER:

Year	Ashe & Jones	J. G. Beard	Mechanical Agents
1976	3,208,533	235,852	154,130
1977	3,961,831	275,244	140,896
1978	4,845,311	338,403	110,870
1979	5,629,888	364,837	155,955
1980	4,699,547	341,262	441,063

All sales made in Washington resulted in payment of commission to the independent sales representative in whose territory the customer was located even if the customer itself directly contacted Tyler Pipe or its subsidiaries.

DEFENDANT'S EXHIBIT NO. 21

INTERROGATORY NO. 25-2:

* * *

- (c) For any sale in Washington during the audit period by you or any subsidiary, was the customer's order initially received by a sales representative and thereafter transmitted by that representative to you or the subsidiary?
- (d) If your answer to part (c) is yes, state as nearly as can be determined both the number of orders thus transmitted by a sales representative and the total number of *all* orders (including orders direct to you or a subsidiary) for delivery in Washington during the audit period.

ANSWER:

* * *

(C.) Yes

- (D.) As nearly as can be determined the number of orders transmitted by a sales representative in the state of Washington was:

	1st 9 MOS			
1976	1977	1978	1979	1980
<u>1,371</u>	<u>1,615</u>	<u>1,442</u>	<u>1,693</u>	<u>1,507</u>

The total number of all orders for delivery in Washington during the audit period was:

	1st 9 MOS			
1976	1977	1978	1979	1980
<u>1,953</u>	<u>2,329</u>	<u>2,522</u>	<u>2,531</u>	<u>2,103</u>

* * *

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DEFENDANT'S EXHIBIT NO. 22

INTERROGATORY NO. 27: For each sales representative identified in the answer to Interrogatory No. 18, describe how, if at all, you or any subsidiary either received or gave information from or to that representative during the audit period regarding market conditions, possible needs for your or your subsidiary's existing products, possible needs for new products or new or different designs for existing products, names of customer purchasing agents or other buyers, or any other information relative to marketing or sales of products of Tyler Pipe or any subsidiary.

ANSWER:

None given.

Market conditions, customer information and product information received verbally.

DEFENDANT'S EXHIBIT NO. 23

INTERROGATORY NO. 27-2:

* * *

(e) State, list and describe each source of information obtained by you or any subsidiary during the audit period for or including the Washington State market regarding market conditions, actual and potential customers, and products.

ANSWER:

* * *

(E.) Ashe & Jones, Inc.
Mechanical Agents, Inc.

DEFENDANT'S EXHIBIT NO. 24**INTERROGATORY NO. 27-3**

(a) Identify each document or natural or non-natural person from which or from whom you or any subsidiary has received since January 1, 1976 information about the Washington market for your (or its) products. If all such information was obtained from sales representatives, you may so state and only identify such representative(s) by company name(s).

* * *

ANSWER:

(A) ALL SUCH INFORMATION WAS COMMUNICATED ORALLY FROM SALES REPRESENTATIVES, ASHE & JONES, INC. AND MECHANICAL AGENTS, INC.

—

DEFENDANT'S EXHIBIT NO. 25

INTERROGATORY NO. 28: For each sales representative identified in the answer to Interrogatory No. 18, identify all employees or other agents of Tyler Pipe or any subsidiary who communicated with the sales representative on the matters identified in the preceding interrogatory. For each employee or agent, estimate the frequency of those communications during the audit period.

ANSWER:

Numbers 4, 5, 6, 7 & 8 of #12.

Average once a month.

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DEFENDANT'S EXHIBIT NO. 27

INTERROGATORY NO. 30: For each sales representative identified in the answer to Interrogatory No. 18, describe all services performed by that representative on behalf of Tyler Pipe or any subsidiary during the audit period. To the extent those services included solicitation of sales for Tyler Pipe or any subsidiary, describe the manner in which the representative solicited such sales, including the territory within Washington in which each representative operated, the means by which each representative contacted potential and/or former customers, and the frequency of those contacts.

ANSWER:

Quotations of our products for specific construction projects and personal calls soliciting an order. Calls made in person or by phone. We have no means of knowing frequency of such contacts.

Ashe & Jones, Inc.—Covers the State of Washington less the following counties: Wahkiakum, Cowlitz, Skamania, Klickitat, Benton, Franklin, Walla Walla. Soil Division.

Mechanical Agents, Inc. represents us in the same area. For Wade only.

Bridgeport Sales, Ltd. represents us for both Divisions in the above listed counties.

DEFENDANT'S EXHIBIT NO. 28

INTERROGATORY NO. 30-2:

- (a) In your answer to defendant's first interrogatory number 30, you stated that all the services performed by Washington sales representatives on behalf of you or any subsidiary during the audit period consisted of quotations of your products and calls soliciting orders. State, describe and explain each other such service performed by a sales representative, including but not limited to furnishing of information about market conditions, customers, and products, handling particular problems as they arose, inspecting products or installations, and otherwise servicing customer accounts.
- (b) Your answer to defendant's first interrogatory number 3 included reference to a "Soil Division." For that division state
 - (1) Its function or purpose, including any changes therein during the audit period;
 - (2) The location of its headquarters, its principal place of business, and the region it served, including any changes, during the audit period; and
 - (3) The organizational structure of its management personnel during the audit period, identifying them (as defined above), including any changes.
- (c) Name the divisions for which Bridgeport Sales, Ltd. represented you during the audit period.

ANSWER:

- (A) Washington sales representatives furnished information about market conditions and customers in the state of Washington.
- (B) Soil Division is a name used internally to describe the DWV Division excluding Wade (specification drainage) products.
 - (1) Same as DWV Division
 - (2) Same as DWV Division
 - (3) Same as DWV Division
- (C) DWV, Utility and Wade.

DEFENDANT'S EXHIBIT NO. 30

INTERROGATORY NO. 33: For each sales representative identified in the answer to Interrogatory No. 18, describe its efforts during the audit period to maintain and improve the name recognition, market share, goodwill, and customer relations of Tyler Pipe and its subsidiaries.

ANSWER:

This is handled entirely by independent sales representatives through sales calls.

DEFENDANT'S EXHIBIT NO. 33

INTERROGATORY NO. 38: During the audit period, were any offers or other potential sales arranged by a sales representative ever rejected by you or any subsidiary? If so, state how many offers and potential sales were accepted and how many rejected by you or any subsidiary during the audit period.

ANSWER:

No.
—

DEFENDANT'S EXHIBIT NO. 40

INTERROGATORY NO. 47-3:

(a) Please state or re-state your answer to defendant's (second) Interrogatory No. 47-2. (The copy provided to counsel did not have an answer.) Specifically, has Tyler Pipe or any subsidiary paid to any other state any tax measured in whole or in part by sales in the State of Washington during the audit period? If your answer is yes, list each such state and, for each, the type of tax paid and the dates and amounts of payment.

* * *

ANSWER:

(A) No tax measured by sales in the State of Washington.

* * *

DEFENDANT'S EXHIBIT NO. 41
TYLER PIPE & FOUNDRY COMPANY
P. O. BOX 2027
TYLER, TEXAS

SALES REPRESENTATION AGREEMENT

THIS AGREEMENT, made the 2nd day of MAY, 1966, between TYLER PIPE & FOUNDRY COMPANY, a Texas corporation, having its principal place of business at Swan, Texas, hereinafter called "Manufacturer", and Ashe & Jones Company of Seattle, Washington, hereinafter called "Representative".

AGREEMENT:

In consideration of the mutual covenants and agreements herein contained, the parties agree as follows:

1. **PRODUCTS:** Manufacturer hereby grants to Representative exclusive selling rights of Manufacturer's products listed in Exhibit "A", in the territory covered by this agreement. The Representative agrees to handle no other product that is or may be competitive to the products covered by this agreement.

2. **TERRITORY:** Manufacturer hereby assigns the territory described in Exhibit "A" to Representative on a protected, exclusive basis for the sale of products covered by this agreement, through the wholesale trade. Representative shall receive no commission except on sales made in his territory. Representative is not authorized to sell for export.

3. **PRICES:** Manufacturer agrees to notify Representative promptly in writing or telegraphically at the address hereon noted, or as may be otherwise requested in writing by Representative, of all price changes. Representative shall promptly notify his customers of such price changes. No increase shall be effective with respect to orders taken by Representative on quotations made by Manufacturer prior to time he shall have received notice of such increase in price. Any reduction in the price shall

apply to all orders that have been placed with the Manufacturer but have not been delivered at the time such reductions in price are made.

4. **CREDIT:** Manufacturer shall have the right to approve the credit of any customer. Representative agrees that he will not negotiate business with concerns of doubtful financial responsibility, and that if any special or unusual financial or other risk is involved in the sale of merchandise, he will fully acquaint Manufacturer with all the facts relating thereto at the time the order is placed. Manufacturer may refuse or reject, either in whole or in part, any order received by the Representative, or may cancel any order in whole or in part, previously accepted by Manufacturer but not shipped, which in the opinion of Manufacturer would result in possible loss to Manufacturer or Representative by its completion. Representative shall not make any commitment binding upon Manufacturer unless he has written permission from Manufacturer to do so.

5. **COMMISSIONS:** Manufacturer agrees to credit Representative with commissions on each approved order on all products covered by this agreement, in accordance with the Commission Schedule, Exhibit "A", upon completion of each respective sale made within his territory for delivery within said territory. Payment of commissions for material shipped will be made within twenty (20) days after close of each four (4) week accounting period as to the amounts due for such accounting period as determined in accordance herewith.

If the customer neglects, fails or refuses to pay any part of the purchase price on a sale where the commission has been paid to the Representative or credited to his account and/or whenever it becomes necessary to take back any of Manufacturer's products sold under this agreement, Representative's commission account shall be charged back with the proportional amount of commission originally credited.

6. **DURATION OF AGREEMENT:** This agreement covers all transactions between Representative and Man-

ufacturer from the date of this agreement. All previous agreements, if any, are hereby cancelled. No changes or additions to the terms of this agreement shall be binding on Manufacturer unless made by an amendment signed by its corporate officers. This agreement shall continue in force and effect until terminated by either party on thirty (30) days notice in writing within one (1) year of the effective date of this contract; sixty (60) days notice in writing within two (2) years of the effective date of this contract; ninety (90) days notice in writing within three (3) years of the effective date of this contract; except that any action of Representative not in accordance with established business practices or tending to impair the integrity or reputation of Manufacturer shall be just and sufficient cause of immediate cancellation by Manufacturer.

7. LAW APPLICABLE: This agreement shall be construed in accordance with the laws of the State of Texas. Jurisdiction and venue of any controversy in relation here-to shall be in Smith County, Texas.

IN WITNESS WHEREOF, the parties have hereunto set their hands and seals the day and year first above written.

[ASHE & JONES
COMPANY]

By: /s/ [Illegible]
Title: Pres.

REPRESENTATIVE

Address of Representative:
225 Terry Ave N.
Seattle, Wash.

TYLER PIPE & FOUNDRY
COMPANY

By: /s/ James B. Horan
Title: Vice-President, Sales

MANUFACTURER

Address of Manufacturer:
P. O. Box 2027
Tyler, Texas

TYLER PIPE & FOUNDRY COMPANY

P. O. BOX 2027
TYLER, TEXAS

EXHIBIT "A"

TERRITORIES COVERED

REPRESENTATIVE	TERRITORY
Ashe & Jones Company 225 Terry Avenue, North Seattle, Washington 98109	51

TERRITORY COVERED:

All State of Montana
Province of British Columbia.

All State of Washington except the following counties:
(Cowlitz, Clark, Skamania, Klickitat, Benton, Franklin and Walla Walla).

The following counties in Idaho: (Boundary, Bonner, Keo-tonia, Shoshone, Benewah, Latah, Clearwater, New Pere, Lewis, Idaho).

COMMISSIONS

Product	Commission Basis
a) Soil Pipe & Soil Fittings	\$ 4.13 Per Ton
b) Ty-Seal Gasket	2.5%
c) Staple Specials & Drains	\$10.00 Per Ton
d) Ty-Tool	6.31%
e) IPS Pipe	\$ 1.50 Per Ton
f) Watermain Pipe	\$ 1.50 Per Ton
g) Specification Drains	
h) SSB Watermain Fittings	\$10.00 Per Ton
i) Flanged Watermain Fittings	\$10.00 Per Ton

- j) Fabricated Watermain Pipe \$10.00 Per Ton
- k) All other Watermain Fittings; Valve, \$ 6.00 Per Ton
Roadway & Service Boxes; Manhole Rings
& Covers; Manhole Steps
- l)
- m)
- n)
- o) Freight

In extreme competitive situations it may be necessary to reduce commission basis below that stated above, although we will make every effort to maintain the commission structure.

NO COMMISSION will be paid on any watermain materials which Tyler Pipe & Foundry Company must purchase from another company.

PLAINTIFF'S EXHIBIT NO. 45

TYLER PIPE
Subsidiary of
Tyler Corporation

GUIDE TO ORDERING

1. To avoid errors, specify catalog item numbers.
2. When ordering Cast Iron Soil Pipe or Cast Iron Soil Fittings be sure to specify class desired; Service Weight (SV) or No-Hub (NH).
3. When ordering Regular Fittings and Closet Bends, give diameters in this order:
 - 1. Main
 - 2. Branch or Branches
 When ordering Reducing or Increasing Fittings give diameters in this order:
 - 1. Spigot of Main
 - 2. Hub of Main
 - 3. Branch of Branches
4. When ordering Long Fittings, (a) Long Bends are measured from the Spigot to the Center Line of the Hub; (b) Long Branch Fittings are measured from the Spigot to the Base of the Hub.
5. To specify right or left side inlets, position fittings as follows and read left or right:
 - a. Regular Bends and Offsets, face open Hub with Spigot down.
 - b. Branch Fittings, face open Hub of Main with Branch down.
 - c. Traps and Closet Bends, face bend as it would be in installed position with hub toward you.
6. All pipe and fittings furnished coated unless otherwise specified.
7. For items not shown in this catalog, call the nearest Sales Office or Plant for quotations and availability.

CONDITIONS OF SALE

Please review individual basic delivered price sheets for each sales division's policy regarding terms, delivery, credit for returns and minimum invoicing.

All claims for return material must be made within ten days after receipt of shipment. When orders have been filled correctly, no credit will be allowed for goods returned unless our written consent has been received. All goods so returned, if accepted, will be credited at cost or prevailing price, whichever is lower at the time, less a minimum handling, transportation and re-conditioning charge when returned on company trucks. Return material shipped LCL or LTL freight must be returned prepaid. Items made to order, especially for an order, are not subject to return or cancellation.

All goods are shipped at purchaser's risk. Claims for damage in transit must be filed with the carrier involved. Shipments should be carefully examined on arrival before signing a receipt. A signed bill of lading or delivery ticket with no exceptions noted will indicate the count, description and condition is satisfactory.

Federal, state and local taxes, if any, will be added to invoices.

All orders are subject to approval of our Home Office before final acceptance. Cancellation or changes in orders are not allowed without our consent. We reserve the right to refuse, cancel or backorder items not in stock or not manufactured by us, whether or not they are shown in this catalog.

All orders and agreements are contingent upon federal, state or municipal action or regulation; strikes or other labor troubles; fire; damage or destruction of merchandise or manufacturing plants; inability to obtain raw materials, labor, fuel or supplies or any other causes whatsoever beyond our control; whether or not similar to any of the causes specifically enumerated, any of which shall release us from performance without liability on orders, agreements, or portions thereof affected.

All orders will be billed according to price in effect at time of shipment. All prices are subject to change without notice.

Possession of this catalog shall not be construed as an offer to sell the products listed.

We warrant to the original purchaser that products of our manufacture are free from defects in material and workmanship. Our obligation under this warranty shall be limited to the repair or replacement at our plant of any products which may prove defective and shall not render us liable for any other or consequential damage to buyer or to any other person.

This warranty is expressly in lieu of all other warranties, expressed or implied, and of all other obligations or liabilities on our part, and we neither assume nor authorize any other person to assume for us any other liability in connection with the sale of our products.

Tyler Pipe, P.O. Box 2027, Tyler, Texas 75710
 (214) 882-5511, Telex 73-5410

PLAINTIFF'S EXHIBIT NO. 46

TYLER PIPE INDUSTRIES, INC.
STATE OF TEXAS FRANCHISE TAXES

	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
TPI—Texas	\$ 6,846.75	\$23,077.50	\$27,897.00	\$31,258.75	\$35,440.75
TPI—Delaware	1,619.25	2,282.25	2,265.25	3,166.25	3,353.25
Wade, Inc.	2,103.75	2,843.25	2,558.50	2,329.00	2,184.50
Tyler Plastics Co.	854.25	964.75	1,037.00	1,534.25	701.25
Tyler Sand	—	—	—	—	—
Swan Development Co.	1,258.00	1,453.50	1,649.00	1,836.00	—
M. J. Harvey Foundation	144.50	157.25	170.00	182.75	199.75
Tyler Custom Molding	55.00	55.00	—	—	—
TOTAL	\$12,881.50	\$30,833.50	\$35,576.75	\$40,307.00	\$41,879.50

PLAINTIFF'S EXHIBIT NO. 47

TYLER PIPE INDUSTRIES, INC.
AD VALOREM TAXES

	STATE & <u>SCHOOL</u>			<u>TOTAL</u>
	<u>SCHOOL</u>	<u>COUNTY</u>	<u>JR. COLLEGE</u>	
1976	\$150,417.28	\$34,296.78	\$ 9,968.79	\$194,682.85
1977	158,436.48	35,423.71	10,361.43	204,221.62
1978	138,787.70	43,027.37	10,945.72	192,760.79
1979	147,722.86	43,317.10	11,012.08	202,052.04
1980	154,711.05	44,708.09	14,364.24	213,783.38

PLAINTIFF'S EXHIBIT NO. 49

TYLER PIPE INDUSTRIES, INC.
Number Of Invoices Issued
By Division

RE: INTERROGATORY 25-2

11/28/83

Number of Orders
Transmitted By a
Sales Representative
in the State
of Washington

	1976	1977	1978	1979	1st 9 Mos. 1980
SOIL	707	825	922	953	532
UTILITY	0	0	0	0	0
PLASTIC	167	173	81	181	47
TOTAL TYLER	874	998	1003	1134	579
WADE	497	617	439	559	928
TOTAL	1371	1615	1442	1693	1507

Number of All
Orders for Delivery
in Washington

SOIL	721	842	941	973	543
UTILITY	555	680	1050	803	565
PLASTIC	170	177	83	185	48
TOTAL TYLER	1446	1699	2074	1961	1156
WADE	507	630	448	570	947
TOTAL	1953	2329	2522	2531	2103

SUPREME COURT OF THE UNITED STATES

No. 85-1963

Tyler Pipe Industries, Inc.

Appellant

v.

Washington Department of Revenue

Appeal from the Supreme Court of Washington,

The statement of jurisdiction in this case having been submitted and considered by the court, probable jurisdiction is noted. This case is consolidated with 85-2006, *National Can Corporation, et al. v. Washington State Department of Revenue* and a total of one hour is allotted for oral argument.

October 6, 1986

Justice Powell and Justice Scalia took no part in the consideration or decision of this petition.

**RELEVANT DOCKET ENTRIES
IN CASE NO. 85-2006**

**DOCKET ENTRIES OF THURSTON COUNTY
SUPERIOR COURT**

<i>Date</i>	<i>Entry</i>	<i>Case Number</i>
12/31/84	Complaints for Refund of Taxes filed for:	
	International Paper Company,	84-2-01888-4
	Chrysler Corporation,	84-2-01889-2
	ASC Pacific, Inc.,	84-2-01890-6
	Korry Electronics Co.,	84-2-01892-2
	Data I/O Corporation,	84-2-01893-1
	R.A. Hanson Co., Inc. & RAHCO, Inc.,	84-2-01894-9
	Ford Motor Company,	84-2-01895-7
	Western Steel Casting Company,	84-2-01896-5
	AMF, Inc., AMF Voit, Inc.,	
	Ben Hogan Co., Paragon Electric Co., Inc., and AMF Head Sportswear, Inc.,	84-2-01898-1
	Westinghouse Electric Corporation,	84-2-01899-0
	Basic American Foods, Inc.,	84-2-01901-5
	Peter Pan Seafoods, Inc.,	84-2-01902-3
	Lone Star Industries,	84-2-01903-1
	Cominco American Inc. & Cominco Electronic Materials Inc.,	84-2-01904-0
	Fentron Building Products Co.,	84-2-01907-4
	Heath Teena Aerospace Co.,	84-2-01908-2
	Clark Equipment Company,	84-2-01909-1
	Advanced Technology Laboratories, Inc.,	84-2-01911-2
	Cummins Engine Company, Inc.,	84-2-01912-1
	Miller Brewing Company,	84-2-01913-9
	American Cyanamid Company, Shulton, Inc. and Jacqueline Cochran, Inc.,	84-2-01914-7

<i>Date</i>	<i>Entry</i>	<i>Case Number</i>
12/31/84	General Brewing Company, Longview Fibre Company, Pabst Brewing Company and Olympia Brewing Company, Quinton Instrument Company, E. M. Matson, Jr., A. H. Robins Company, Armstrong World Industries, Inc. and Thomasville Furniture Industries, Inc., G. Heileman Brewing Co., Inc. and Rainier Brewing Company, Allis-Chalmers Corporation, North Pacific Processors, Inc., Alaska Pacific Seafoods, and Kenai Salmon Packing Co., Bethlehem Steel Corporation, U.S. Oil & Refining Co., Noel Canning Corporation, Trident Seafoods Corporation, Foseco, Inc., Mattel, Inc., Welch Foods, Inc., Kalama Chemical, Inc., Xerox Corporation, National Can Corporation,	84-2-01915-5 84-2-01917-1 84-2-01918-0 84-2-01919-8 84-2-01920-1 84-2-01921-0 84-2-01922-8 84-2-01923-6 84-2-01924-4 84-2-01925-2 84-2-01926-1 84-2-01927-9 84-2-01928-7 84-2-01929-5 84-2-01930-9 84-2-01931-7 84-2-01932-5 84-2-01891-4 84-2-01916-3 84-2-01900-7
1/21/85	First Amended Complaints For Refund of Taxes Filed For: International Paper Company, Chrysler Corporation, ASC Pacific, Inc.,	84-2-01888-4 84-2-01889-2 84-2-01890-6

<i>Date</i>	<i>Entry</i>	<i>Case Number</i>
1/21/85	Korry Electronics Co., Data I/O Corporation, R.A. Hanson Co., Inc. & RAHCO, Inc., Ford Motor Company, Western Steel Casting Company, AMF, Inc., AMF Voit, Inc., Ben Hogan Co., Paragon Electric Co., Inc., and AMF Head Sportswear Co., Inc., Westinghouse Electric Corporation, Basic American Foods, Inc., Peter Pan Seafoods, Inc., Lone Star Industries, Comineo American Inc. & Comineo Electronic Materials Inc., Fentron Building Products Co., Heath Teena Aerospace Co., Clark Equipment Company, Advanced Technology Laboratories, Inc., Cummins Engine Company, Inc., Miller Brewing Company, American Cyanamid Company, Shulton, Inc. and Jacqueline Cochran, Inc., General Brewing Company, Longview Fibre Company, Pabst Brewing Company and Olympia Brewing Company.	84-2-01892-2 84-2-01893-1 84-2-01894-9 84-2-01895-7 84-2-01896-5 84-2-01898-1 84-2-01899-0 84-2-01901-5 84-2-01902-3 84-2-01903-1 84-2-01904-0 84-2-01907-4 84-2-01908-2 84-2-01909-1 84-2-01911-2 84-2-01912-1 84-2-01913-9 84-2-01914-7 84-2-01915-5 84-2-01917-1 84-2-01918-0

<i>Date</i>	<i>Entry</i>	<i>Case Number</i>
1/21/85	Quinton Instrument Company, E. M. Matson, Jr., A. H. Robins Company, Armstrong World Industries, Inc. and Thomasville Furniture Industries, Inc., G. Heileman Brewing Co., Inc. and Rainier Brewing Company, Allis-Chalmers Corporation, North Pacific Processors, Inc., Alaska Pacific Seafoods, and Kenai Salmon Packing Co., Bethel Steel Corporation, U.S. Oil & Refining Co., Noel Canning Corporation, Trident Seafoods Corp., Foseco, Inc., Mattel, Inc., Welch Foods, Inc., Kalama Chemical, Inc., Xerox Corporation, National Can Corporation,	84-2-01919-8 84-2-01920-1 84-2-01921-0 84-2-01922-8 84-2-01923-6 84-2-01924-4 84-2-01925-2 84-2-01926-1 84-2-01927-9 84-2-01928-7 84-2-01929-5 84-2-01930-9 84-2-01931-7 84-2-01932-5 84-2-01891-4 84-2-01916-3 84-2-01900-7
1/25/85	Motion For Partial Summary Judgment Filed For Kalama Chemical, Inc.,	84-2-01891-4
1/28/85	Motion for Preassignment of Xerox Corporation, Kalama Chemical, Inc.	84-2-01916-3 84-2-01891-4

<i>Date</i>	<i>Entry</i>	<i>Case Number</i>
1/31/85	Motion For Partial Summary Judgment Filed For Xerox Corporation	84-2-01916-3
2/ 4/85	Order Preassigning Xerox Corporation, Kalama Chemical, Inc.	84-2-01916-3 84-2-01891-4
3/18/85	Order Preassigning National Can Corporation	84-2-01900-7
5/21/85	Complaints for Refund of Taxes Filed For Alaskan Copper Companies, Inc., 85-2-00863-1 The Firestone Tire & Rubber Co., 85-2-00864-0 General Electric Co., 85-2-00865-8 Honeywell Inc., 85-2-00866-6 Reynolds Metals Corporation, 85-2-00867-4 Square D Company, 85-2-00868-2 E. R. Squibb & Sons, Inc., Spacelabs, Inc., Charles of the Ritz Group, Ltd., and Edward Week & Company, Inc., 85-2-00869-1 Alpac Corporation, 85-2-00870-4	
5/21/85	Motion for Injunction Staying Collection of Taxes Filed For National Can Corporation, Xerox Corporation, Kalama Chemical, Inc.	84-2-01900-7 84-2-01916-3 84-2-01891-4

<i>Date</i>	<i>Entry</i>	<i>Case Number</i>
5/21/85	Motion and Order Making Judgment Rendered in Test Cases Applicable to all Appellants	84-2-01900-7 84-2-01916-3 84-2-01891-4
5/22/85	Complaint for Refund of Taxes Filed For Scott Paper Company	85-2-00879-8
5/22/85	Second Amended Complaint For Refund of Taxes Filed For Xerox Corporation	84-2-01916-3
5/22/85	Motion for Summary Judgment Filed For National Can Corporation, Xerox Corporation, Kalama Chemical, Inc.	84-2-01900-7 84-2-01916-3 84-2-01891-4
5/28/85	Complaints for Refund of Taxes Filed For Mars, Inc., Kal Kan Foods, Inc., and Uncle Ben's, Inc., W. R. Grace & Co., Murray Pacific Corp.	85-2-00919-1 85-2-00920-4 85-2-00921-2
6/24/85	Amended Complaints for Refund of Taxes Filed For Alaskan Copper Companies, Inc., The Firestone Tire & Rubber Co., General Electric Co., Honeywell Inc., Reynolds Metals Corporation, Square D Company,	85-2-00863-1 85-2-00864-0 85-2-00865-8 85-2-00866-6 85-2-00867-4 85-2-00868-2

<i>Date</i>	<i>Entry</i>	<i>Case Number</i>
6/24/85	E. R. Squibb & Sons, Inc., Spacelabs, Inc., Charles of the Ritz Group, Ltd., and Edward Weck & Company, Inc., Alpac Corporation, Scott Paper Company, Mars, Inc., Kal Kan Foods, Inc. and Uncle Ben's, Inc., W. R. Grace & Co., Murray Pacific Corp.	85-2-00869-1 85-2-00870-4 85-2-00879-8 85-2-00919-1 85-2-00920-4 85-2-00921-2
6/24/85	Memorandum Opinion Filed in National Can Corporation, Xerox Corporation, Kalama Chemical, Inc.	84-2-01900-7 84-2-01916-3 84-2-01891-4
7/10/85	Motions and Cross Motions for Summary Judgment Filed in National Can Corporation, Xerox Corporation, Kalama Chemical, Inc., Alaskan Copper Companies, Inc., The Firestone Tire & Rubber Co., General Electric Co., Honeywell Inc., Reynolds Metals Corporation, Square D Company, E. R. Squibb & Sons, Inc., Spacelabs, Inc., Charles of the Ritz Group, Ltd., and Edward Weck & Company, Inc., Alpac Corporation, Scott Paper Company, Mars, Inc., Kal Kan Foods, Inc., and Uncle Ben's, Inc., W. R. Grace & Co., Murray Pacific Corp., International Paper Company, Chrysler Corporation, ASC Pacific, Inc.,	84-2-01900-7 84-2-01916-3 84-2-01891-4 85-2-00863-1 85-2-00864-0 85-2-00865-8 85-2-00866-6 85-2-00867-4 85-2-00868-2 85-2-00919-1 85-2-00920-4 85-2-00921-2 84-2-01888-4 84-2-01889-2 84-2-01890-6

<i>Date</i>	<i>Entry</i>	<i>Case Number</i>
7/10/85	Korry Electronics Co., Data I/O Corporation, R.A. Hanson Co., Inc. & RAHCO, Inc.,	84-2-01892-2 84-2-01893-1
	Ford Motor Company,	84-2-01894-9
	Western Steel Casting Company,	84-2-01895-7
	AMF, Inc., AMF Voit, Inc.,	84-2-01896-5
	Ben Hogan Co., Paragon	
	Electric Co., Inc., and AMF	
	Head Sportswear, Inc.,	84-2-01898-1
	Westinghouse Electric	
	Corporation,	84-2-01899-0
	Basic American Foods, Inc.,	84-2-01901-5
	Peter Pan Seafoods, Inc.,	84-2-01902-3
	Lone Star Industries,	84-2-01903-1
	Comineo American Inc. &	
	Comineo Electronic	
	Materials, Inc.,	84-2-01904-0
	Fentron Building Products Co.,	84-2-01907-4
	Heath Teena Aerospace Co.,	84-2-01908-2
	Clark Equipment Company,	84-2-01909-1
	Advanced Technology	
	Laboratories, Inc.,	84-2-01911-2
	Cummins Engine Company, Inc.,	84-2-01912-1
	Miller Brewing Company,	84-2-01913-9
	American Cyanamid Company,	
	Shulton, Inc. and	
	Jacqueline Cochran, Inc.,	84-2-01914-7
	General Brewing Company,	84-2-01915-5
	Longview Fibre Company,	84-2-01917-1
	Pabst Brewing Company and	
	Olympia Brewing Company,	84-2-01918-0
	Quinton Instrument Company,	84-2-01919-8
	E. M. Matson, Jr.,	84-2-01920-1
	A. H. Robins Company,	84-2-01921-0
	Armstrong World Industries,	
	Inc. and Thomasville Furniture	
	Industries, Inc.,	84-2-01922-8

<i>Date</i>	<i>Entry</i>	<i>Case Number</i>
7/10/85	G. Heileman Brewing Co., Inc. and Rainier Brewing Company, Allis-Chalmers Corporation, North Pacific Processors, Inc., Alaska Pacific Seafoods, and	84-2-01923-6 84-2-01924-4
	Kenai Salmon Packing Co.,	84-2-01925-2
	Bethlehem Steel Corporation,	84-2-01926-1
	U.S. Oil & Refining Co.,	84-2-01927-9
	Noel Canning Corporation,	84-2-01928-7
	Trident Seafoods Corporation,	84-2-01929-5
	Foseco, Inc.,	84-2-01930-9
	Mattel, Inc.,	84-2-01931-7
	Welch Foods, Inc.,	84-2-01932-5
7/19/85	<i>Stipulation and Order Consolidating all of Appellants' Actions Into <i>National Can Corporation vs. State of Washington Department of Revenue, Cause</i> No. 84-2-01900-7</i>	All of the Above
7/19/85	<i>First Stipulation Re : Exhibits Pertaining to Washington State Budget and Revenues, Including Exhibits 1-31 Filed</i>	84-2-01900-7
7/19/85	<i>Exhibit 32: Confidential Report in Sealed Envelope Admitted for Limited Purpose</i>	84-2-01891-4
7/19/85	<i>Summary Judgment Entered Against National Can Corporation and All Other Appellants</i>	All of the Above
8/ 5/85	<i>Notice of Appeal to Washington Supreme Court Filed</i>	84-2-01900-7

<i>Date</i>	<i>Entry</i>	<i>Case Number</i>
3/28/86	Mandate Received	84-2-01900-7
5/22/86	Notice of Appeal to the Supreme Court of the United States Filed	84-2-01900-7

**DOCKET ENTRIES OF
WASHINGTON SUPREME COURT**

8/ 5/85	Notice of Appeal to Washington Supreme Court Filed	51910-2
8/ 7/85	Statement of Grounds For Direct Review Filed	51910-2
9/30/85	Motion for Accelerated Review Filed	51910-2
10/ 4/85	Notation Order Granting Accelerated Direct Review, Combining <i>Tyler Pipe Industries, Inc. vs. State of Washington Department of Revenue</i> , No. 51110-1 With <i>National Can</i> for Purposes of Oral Argument and Granting <i>National Can</i> $\frac{2}{3}$ of Oral Argument Time	51910-2
3/ 6/86	Opinion Filed	51910-2
3/27/86	Mandate Filed	51910-2
5/22/86	Notice of Appeal to the Supreme Court of the United States Filed	51910-2

**KALAMA CHEMICAL, INC.,
STIPULATION OF FACTS**

[Filed May 1, 1985]

IN THE SUPERIOR COURT OF
THE STATE OF WASHINGTON
FOR THURSTON COUNTY

KALAMA CHEMICAL, INC.,
Plaintiff,

v.

STATE OF WASHINGTON,
DEPARTMENT OF REVENUE,
Defendant.

NO. 84-2-01891-4

STIPULATION OF FACTS

The parties jointly stipulate that to the best of their knowledge and belief the following facts are true and correct:

1. Kalama Chemical, Inc. ("Kalama" or "the company"), is a Washington corporation, having its corporate office in Seattle, Washington.
2. Kalama manufactures and sells chemical products. Its products are sold primarily outside the State of Washington and in the export market.
3. Kalama operates manufacturing facilities in Kalama, Washington, and Garfield, New Jersey. Kalama maintains stocks of its goods (including those it manufactures in Washington) in Illinois, California, New Jersey, Indiana, New York, and Texas (as well as Washington). The original cost of Kalama's property in Washington is \$23,762,321. The original cost of its property every-

where (including Washington) is \$30,039,160. (Both costs are as of Kalama's fiscal year ended June 30, 1984, and include leased property, based on eight times the net annual rental rate.)

4. In order to sell Washington-manufactured products outside Washington, Kalama employs sales representatives and others whose activities outside Washington contribute to the value of the products that are manufactured in Washington and sold outside this state. The cost of their activities is included in the price Kalama received for those products.

5. Kalama employs a total of approximately 175 people. Approximately 95 of them are employed in Washington and 80 are employed in other states. The company's Washington payroll was \$3,297,524 for its fiscal year ended June 30, 1984. Its total payroll everywhere was \$6,635,515 for the same period.

6. Kalama's employees in Washington include management/administrative personnel, plant workers, engineers, office personnel, and others whose activities in Washington contribute to the value of the products that are manufactured in this state. The cost of their activities is included in the price Kalama receives for those products.

7. As reported on its returns filed with the Washington State Department of Revenue for business and occupation tax purposes, Kalama's annual out-of-state sales of products manufactured in Washington ranged from \$23,981,057 to \$29,693,132 during the period January 1, 1980, through December 31, 1984. Kalama paid manufacturing business and occupation taxes to Washington of \$495,612.59 (including interest) during that period.

8. Kalama's total sales everywhere were \$46,779,613 during its fiscal year ended June 30, 1984. Its sales in Washington were \$2,580,766 during the same period.

9. Kalama pays taxes to other jurisdictions on income derived in those locations from the sale of products manufactured in Washington. Kalama pays income tax to the states of California, New Jersey, and Illinois ("the Market States") on the income Kalama derives from the sale in those states of products manufactured in Washington. The income taxed by the Market States is Kalama's gross receipts (i.e., its gross income of every kind and from every source, including its gross proceeds from goods manufactured in Washington and sold in the Market States), minus certain deductions permitted by statute, and multiplied by an apportionment factor. The taxes imposed by the Market States are apportioned on the basis of a three-factor formula that compares Kalama's property, payroll, and sales in those states to its property, payroll, and sales everywhere. For goods Kalama manufactures in Washington and sells in one of the Market States, Kalama's gross proceeds from those goods are attributed to the Market State and are, therefore, included in the numerator of its "sales" or "receipts" factor. Kalama's gross proceed from the same goods are also used by Washington as the measure of its manufacturing tax on Kalama.

10. Kalama pays franchise tax to the State of Texas. The basis of the franchise tax is the corporation's "taxable capital" allocated to Texas. The "taxable capital" of a corporation is its stated capital (*e.g.*, the par value of all shares issued having a par value) and its surplus. The "taxable capital" of a corporation is allocated to Texas

through an apportionment formula. Under the formula "taxable capital" is multiplied by a fraction, the numerator of which is the corporation's gross receipts from business done in Texas and the denominator of which is gross receipts from its entire business. Gross receipts includes the gross proceeds from sales delivered in Texas, services performed in Texas and other business done in Texas. For goods Kalama manufactures in Washington and sells in Texas, Kalama's gross proceeds from those goods are attributed to Texas and are, therefore, included in the numerator of Texas' apportionment formula as receipts from business done in Texas. Washington uses those same gross proceeds as the measure of its manufacturing tax on Kalama.

11. Kalama borrowed and invested funds during the years 1980 through 1984 in the generally available money markets. Kalama's experience with respect to the cost of borrowing money and its return on invested money reflected the prevailing market rates of interest.

12. No claims for refund are made by Kalama in this action on behalf of any corporation that is or has been a subsidiary or affiliate of Kalama. This stipulation is not a waiver of any such claims and is without prejudice to any right any past or present Kalama subsidiary or affiliated corporation may have to seek such relief in a separate action.

KENNETH O.
EIKENBERRY
Attorney General
State of Washington

/s/ William B. Collins
William B. Collins
Assistant Attorney General
Attorneys for Defendant

BOGLE & GATES
/s/ D. Michael Young
D. Michael Young
Attorneys for Plaintiff

NATIONAL CAN CORPORATION STIPULATION OF FACTS

[Filed May 17, 1985]

IN THE SUPERIOR COURT OF
THE STATE OF WASHINGTON
FOR THURSTON COUNTY
NATIONAL CAN CORPORATION,
Plaintiff,

v.
STATE OF WASHINGTON
DEPARTMENT OF REVENUE,
Defendant.

NO. 84-2-01900-7

STIPULATION OF FACTS

The parties jointly stipulate that to the best of their knowledge and belief the following facts are true and correct:

1. National Can Corporation ("NCC") is a Delaware corporation, having its principal office in Chicago, Illinois.
2. NCC manufactures and sells packaging products. NCC's products are sold throughout the world.
3. NCC operates manufacturing facilities in 22 states, including Washington. NCC maintains offices in 25 states, including Washington. Exhibit A, which lists NCC's offices and facilities throughout the United States, is incorporated by reference as a part of this stipulation. The original cost of NCC's property in Washington was ap-

proximately \$31.9 million. The original cost of its property everywhere (including Washington) was \$899 million. (Both costs are as of 1983 and include leased property, based on eight times the net annual rental rate.)

4. In order to sell NCC packaging products in Washington and elsewhere, NCC maintains plants, offices, warehouses and other facilities in states other than Washington, and employs many people outside the State of Washington, including factory workers, engineers, scientists, laboratory technicians, accountants, lawyers, office personnel, warehouse personnel, industrial and public relations personnel, computer programmers, data processors, and other employees whose activities outside Washington contribute to the value of the products that are sold in Washington. The cost of their activities is included in the price NCC receives for those products.

5. In order to sell its products outside Washington, (including the products it manufactures in Washington), NCC maintains offices, warehouses, and other facilities in states other than Washington, and employs many people outside the State of Washington, including sales representatives, engineers, scientists, laboratory technicians, accountants, lawyers, office personnel, warehouse personnel, industrial and public relations personnel, computer programmers, data processors, and other employees whose activities outside Washington contribute to the value of the products that are manufactured in Washington and sold outside this state. The cost of their activities is included in the price NCC receives for those products.

6. NCC employs approximately 10,400 people worldwide. Approximately 240 of NCC's employees are in

Washington. In 1983, NCC's Washington payroll was approximately \$7.6 million. Its total payroll everywhere was approximately \$238 million.

7. In order to sell NCC packaging products in Washington, NCC maintains a sales office and employs 7 sales and office personnel in Washington whose activities contribute to the value of products sold in this state. The cost of their activities is included in the price NCC receives for those products.

8. In order to manufacture NCC products in Washington, NCC maintains two plants and employs factory workers, engineers, office personnel and others in Washington whose activities contribute to the value of the products that are manufactured in Washington and sold outside this state. The cost of their activities is included in the price NCC receives for those products.

9. As reported on returns filed with the Washington State Department of Revenue for business and occupation tax purposes, NCC's annual Washington sales of products manufactured outside Washington ranged from \$19.9 million to \$32 million during the period January 1, 1980, through December 31, 1984. NCC paid wholesaling taxes to Washington of \$606,863.26 on such sales during that period.

10. As reported on returns filed with the Washington State Department of Revenue for business and occupation tax purposes, NCC's annual out-of-state sales of products manufactured in Washington ranged from \$11.3 million to \$18.7 million during the period January 1, 1980, through December 31, 1984. NCC paid manufacturing taxes to Washington of \$372,843.78 during that period.

11. As reported on returns filed with the Washington State Department of Revenue for business and occupation tax purposes, NCC's gross receipts from goods both manufactured and sold in Washington ranged from \$71.4 million to \$78.5 million during the period January 1, 1980, through December 31, 1984. NCC paid wholesaling taxes to Washington of approximately \$1,800,000 on such gross receipts during that period.

12. Between January 1, 1980 and December 31, 1984, NCC paid approximately \$2,800,000 in Washington State business and occupation taxes. In this action, NCC is seeking a refund of approximately \$980,000 plus reasonable interest.

13. NCC's 1983 total sales everywhere were approximately \$1.552 billion. Its 1983 sales in Washington were approximately \$110 million.

14. NCC pays taxes to other jurisdictions on income derived in those locations from the sale of products manufactured in Washington. NCC pays taxes to the states of Arizona, California, Georgia, Illinois, Minnesota, Oregon and Wisconsin ("the Market States") on the income NCC derives from the sale in those states of [sic] products manufactured in Washington. The income taxed by the Market States is NCC's gross receipts (i.e., its gross income of every kind and from every source, including its gross proceeds from goods manufactured in Washington and sold in the Market States), minus certain deductions permitted by statute, and multiplied by an apportionment factor. The state income taxes imposed by the Market States are apportioned on the basis of a three-factor

formula that compares NCC's property, payroll, and sales in those states to its property, payroll, and sales everywhere. [sic] For goods NCC manufactures in Washington and sells in one of the Market States, NCC's gross proceeds from those goods are attributed to the Market State and are, therefore, included in the numerator of its "sales" or "receipts" factor. NCC's gross proceeds from the same goods are also used by Washington as the measure of its manufacturing tax on NCC.

15. NCC pays taxes to other jurisdictions on income derived from its sales of products in Washington. NCC pays taxes to the State of California on the income NCC derives from manufacturing goods in California and selling them in Washington. NCC's gross proceeds from the same goods are also used by Washington as the measure of its wholesaling tax on NCC. The income taxed by California is NCC's gross receipts (i.e., its gross income of every kind and from every source, including its gross proceeds from goods manufactured in that state and sold in Washington), minus certain deductions permitted by statute, and multiplied by an apportionment factor. California's tax is apportioned on the basis of a three-factor formula that compares NCC's property, payroll, and sales in California to its property, payroll, and sales everywhere. For goods NCC manufactures in California and sells in Washington, the property and payroll of NCC's plants that produce those goods and of its offices in the manufacturing state are included in the numerator of that state's property and payroll factors, respectively.

16. Washington is the only state in which NCC is subjected to a gross receipts tax measured by 100% of

the gross receipts from the sale of products manufactured in and sold outside the taxing state.

17. Between 1980 and 1984, NCC manufactured some articles in Washington for its own use. The total value of products so manufactured does not exceed \$10,000. NCC paid manufacturing B&O tax to Washington on that activity, and such tax is not included in the amount of the refund sought in this action.

18. NCC borrowed and invested funds during the years 1980 through 1984 in the generally available money markets. NCC's cost of borrowing money and its return on invested money were interest in the range of ½% to 2½% over the prevailing prime lending rate.

19. No claims for refunds are made by NCC in this action on behalf of any corporation that is or has been a subsidiary of [sic] affiliate of NCC. This stipulation is not a waiver of any such claims and is without prejudice to any right any past or present NCC subsidiary or affiliated corporation may have to seek such relief in a separate action.

KENNETH O.
EIKENBERRY
Attorney General
State of Washington

/s/ William B. Collins
William B. Collins
Assistant Attorney General
Attorneys for Defendant

BOGLE & GATES
/s/ D. Michael Young
D. Michael Young
Attorneys for Plaintiff

REVISED 03/21/84

STIPULATION OF FACTS
EXHIBIT A

NATIONAL CAN CORPORATION SUMMARY OF REAL PROPERTY LOCATIONS IN THE U.S.				
ST	ZIP	CTY	CITY	STREET ADDRESS
AL	38215	—	Birmingham	124 Carbon Road, P.O. Box 94067
AZ	85031	—	Phoenix	211 N. 51st Avenue
CA	94010	—	Burlingame	P.O. Box 1699, 1657 Rollins Road
CA	94010	—	Burlingame	1657 Rollins Road
CA	94010	—	Burlingame	1657 Rollins Road
CA	90701	—	Cerritos	11544 South Street, P.O. Box 8000
CA	91744	—	City of Industry	437 North Baldwin Park Boulevard
CA	90023	—	Los Angeles	2615 South Bonnie Beach Place
CA	90023	—	Los Angeles	4212 East 26th Street
CA	90040	—	Maywood	4855 East 52nd Place
CA	95351	—	Modesto	430 Doherty Avenue
CA	94577	—	San Leandro	2050 Williams Street
CT	06810	—	Danbury	Great Pasture Road
CT	06801	—	Danbury	Old Ridgebury Road, P.O. Box 160
CT	06801	—	Danbury	Old Ridgebury Road, P.O. Box 160
FL	32205	—	Jacksonville	33331 West 12th Street
GA	30345	—	Atlanta	1760 Century Circle

IL	60638	—	Bedford Park	7300 South Narragansett Avenue	CLOSURE	PLANT
IL	60638	—	Bedford Park	7420 South Meade Avenue	PLANT	PLANT
IL	60651	—	Chicago	1031 North Cicero Avenue	CLOSURE	PLANT
IL	60609	—	Chicago	1101 West 43rd Street	MCD	PLANT
IL	60638	—	Chicago	5620 West 51st Street	MCD	SALES
IL	60638	—	Chicago	5620 West 51st Street	MCD	SALES
IL	60631	—	Chicago	8101 West Higgins Road	EXECUTIVE	HDQ
IL	60631	—	Chicago	8101 West Higgins Road	MCD	SALES
IL	60631	—	Chicago	8101 West Higgins Road	PLATICS	HDQ
IL	60631	—	Chicago	1000 East Northwest Highway	MCD	PLANT
IL	60631	—	Chicago	1000 East Northwest Highway	CENG	OFFICE
IL	60016	—	Des Plaines	1000 East Northwest Highway	MCD	PLANT
IL	60016	—	Des Plaines	2500 Lively Boulevard	MCD	ART
IL	60007	—	Elk Grove Village	2520 Lively Boulevard	PLATICS	PLANT
IL	60143	—	Elk Grove Village	751 North Hilltop Avenue	MCD	SALES
IL	60143	—	Itasca	750 North Hilltop Avenue	PLATICS	PLANT
IL	61111	—	Loves Park	5800 Industrial Avenue	MCD	PLANT
IL	60521	—	Oaksbrook	1211 West 22nd Street	MCD	SALES
IL	60068	—	Park Ridge	400 West Higgins Road	GLASS	SALES
IL	61109	—	Rockford	627 Grable Street	CEQS	PLANT
IN	47705	—	Evansville	2201 West Harland Street	CLOSURE	PLANT
IN	46404	—	Oary	North Bridge Street	MCD	WAREHOUSE
IN	46350	—	La Porte	300 North Fall Road	MCD	SALES
IN	46952	—	Marion	P.O. Box 249	GLASS	PLANT
IN	46952	—	Marion	P.O. Box 249, East Charles Street	EXECUTIVE	HDQ
IN	46390	—	Wanatah	US Highway 30	MCD	PLANT

MA	01757	—	Milford	P.O. Box 398, National Avenue	GLASS	PLANT
MA	02162	—	Newton Lower Falls	2345 Washington Street	MCD	SALES
MA	02162	—	Newton Lower Falls	2345 Washington Street	GLASS	SALES
MD	21207	—	Baltimore	7133 Rutherford Road	MCD	WAREHOUSE
MD	21230	—	Baltimore	2147 Wicohico	GLASS	SALES
MD	21093	—	Sparrows Point	10 Berard Avenue	MCD	PLANT
MD	21219	—	Sparrows Point	2010 Reservoir Road	CEQS	OFFICE
MD	21219	—	Sparrows Point	2010 Reservoir Road	MCD	PLANT
MI	48084	—	Troy	3221 West Big Beaver Road	GLASS	SALES
MN	55107	—	St. Paul	139 Eva Street	MCD	PLANT
MN	55107	—	St. Paul	139 Eva Street	CEQS	OFFICE
MN	55113	—	St. Paul	1805 W. County Road C	MCD	PLANT
MN	55114	—	St. Paul	2085 Ellis Avenue	PLATICS	PLANT
MN	55110	—	White Bear Lake	3564 Rolling View Drive	MCD	SALES
MO	63105	—	Clayton	135 North Meramec Avenue	GLASS	SALES
MO	63105	—	Clayton	222 South Meramec Avenue	MCD	SALES
MO	63105	—	Clayton	222 South Meramec Avenue	CEQS	OFFICE
MO	63070	—	Pevely	P.O. Box 615, Hwy. 61 & 67	GLASS	PLANT
MO	63132	—	St. Louis	10777 Baur Boulevard	PLATICS	PLANT
MS	39567	—	Pascagoula	3202 Denny Avenue	MCD	PLANT
NC	28209	—	Charlotte	1515 Mockingbird Lane	GLASS	SALES
NC	27893	—	Wilson	P.O. Box 1757, 2200 Firestone Parkway	GLASS	PLANT

NJ	07066	—	Clark	67 Walnut Avenue	PLANT
NJ	07066	—	Clark	67 Walnut Avenue	SALES
NJ	08817	—	Edison	135 National Road	PLANT
NJ	08332	—	Millville	P.O. Box 150 South 2nd St.	PLANT
NJ	08854	—	Piscataway	South Randolphville Rd at Rt. 287	PLANT
NY	14618	—	Rochester	1467 Monroe Avenue	SALES
NY	10607	—	White Plains	297 Knollwood Rd.	SALES
OH	43502	—	Archbold	R.R. #3, Box 9B	PLANT
OH	45246	—	Cincinnati	#7 Triangle Park Drive	SALES
OH	43227	—	Columbus	6100 Channingway Blvd.	SALES
OH	43302	—	Marion	1240 West Center Street	PLANT
OH	43207	—	Obetz	2120 Buzick Drive	PLANT
OH	44481	—	Warren	Griswold Street Exit	PLANT
OK	73179	—	Oklahoma City	3400 South Council Road	PLANT
OK	73107	—	Oklahoma City	3810 Northwest 3rd Street	PLANT
PA	18051	—	Fogelsville	100 National Drive	PLANT
PA	17331	—	Hanover	RD H3 Box 22	PLANT
PA	16301	—	Oil City (Closed)	P.O. Box 334, Rouseville Rd.	PLANT
PA	15235	—	Pittsburgh	201 Penn Center Blvd., Office 407	SALES
PA	19462	—	Plymouth Meeting	661 West Germantown Pike	SALES
PA	19482	—	Valley Forge	P.O. Box 964	SALES
SC	29010	—	Bishopville	609 Cougar Street	PLANT

TN	38017	—	Collierville	110 South Byhalia Road	PLANT
TN	38119	—	Memphis	1255 Lynfield Road	SALES
TX	76011	—	Arlington	2205 East Randol Hill Road	PLANT
TX	76140	—	Fort Worth	8800 South Freeway	PLANT
TX	77029	—	Houston	8501 East Freeway	SALES
TX	77339	—	Kingwood	2218 North Park, Suite K	PLANT
TX	75165	—	Waxahachie	P.O. Box 677, I Hwy. 35-E at Hwy. 287	SALES
WA	98031	—	Kent	1220 North Second Avenue	PLANT
WA	98055	—	Renton	15 South Grady Way	SALES
WA	98660	—	Vancouver	2601 N.W. Lower River Road	PLANT
WI	53105	—	Burlington	P.O. Box 120, South McHenry St.	PLANT
WI	54306	—	Green Bay	P.O. Box 2386	PLANT
WI	53222	—	Wauwatosa	10721 West Capitol Drive	SALES

XEROX CORPORATION STIPULATION OF FACTS

[Filed May 17, 1985]

**IN THE SUPERIOR COURT OF WASHINGTON
FOR THURSTON COUNTY**

XEROX CORPORATION,

Plaintiff,

v.

**STATE OF WASHINGTON,
DEPARTMENT OF REVENUE**

Defendant.

NO. 84-2-01916-3

STIPULATION OF FACTS

The parties jointly stipulate that to the best of their knowledge and belief the following facts are true and correct:

1. Xerox Corporation ("Xerox") is a New York corporation, having its corporate office in Stamford, Connecticut.
2. Xerox manufactures and sells office equipment. Xerox products are sold throughout the world. None of this equipment is manufactured in Washington State.
3. Xerox operates manufacturing facilities in New York, California, and Texas. Xerox maintains offices in 48 states, including Washington.
4. Xerox operates regional distribution centers. Each distribution center handles specific and limited product lines. For example, Xerox duplicating equipment sold in Washington is distributed through the Santa Fe Springs, California, regional distribution center. Xerox typewriters and other nonduplicating office equipment sold in

Washington are distributed through the Dallas, Texas, regional distribution center. Xerox office supplies sold in Washington are distributed through the Compton, California, distribution center. Xerox does not operate a distribution center in Washington.

5. Xerox's administrative functions are performed in regional headquarters. For example, Xerox sales representatives selling in Washington are responsible to a regional sales office in Walnut Creek, California. Xerox's West Coast tax operations are headquartered in Santa Ana, California. The Santa Ana office has responsibility for tax planning in 17 western states, including Washington. Credit collection policy, advertising and marketing strategy, and salesmen compensation plans are developed and administered at Xerox's Rochester, New York, office. Central administrative functions are not performed in Washington.

6. The original cost of Xerox's property in Washington was \$25,919,898. The original cost of its property everywhere (including Washington) was \$4,544,650,836. (Both costs are as of 1983 and include leased property, based on eight times the net annual rental rate.)

7. In order to sell Xerox-manufactured products in Washington and elsewhere, Xerox employs many people outside the state of Washington, including factory workers, engineers, architects, scientists, laboratory technicians, accountants, lawyers, office personnel, warehouse personnel, computer programmers, data processors, and other employees. Their activities outside Washington contribute to the value of the products that are sold in Washington. The cost of their activities is included in the price Xerox receives for those products.

8. Xerox employs approximately 55,000 people. Approximately 460 of Xerox's employees are in Washington and 54,540 are in other states. In 1983, Xerox's Washington payroll was \$13,875,256. Its total payroll everywhere in 1983 was \$1,751,280,789.

9. In order to sell Xerox-manufactured products in Washington, Xerox maintains sales offices, services offices, and a products demonstration center in Washington, and employs sales representatives, service technicians, clerical/administrative personnel, and others in Washington whose activities contribute to the value of products sold in this state. The cost of their activities is included in the price Xerox receives for those products.

10. As reported on returns filed with the Washington State Department of Revenue for business and occupation tax purposes, Xerox's annual Washington sales of products manufactured outside Washington ranged from \$64.4 million to \$75.7 million during the period January 1, 1980, through December 31, 1984. Xerox paid retailing and wholesaling taxes to Washington of \$1,537,075.68 during that period.

11. Xerox's 1983 total sales everywhere were \$4,963,342,857. Its 1983 sales in Washington were \$67,569,385.

12. Xerox pays taxes to other jurisdictions on income derived from its sale of products in Washington. Xerox pays taxes to the states of California and New York on the income Xerox derives from manufacturing goods in those states and selling them in Washington. Xerox's gross proceeds from the same goods are also used by Washington as the measure of its retailing and wholesaling taxes on Xerox. The income taxed by California and New York is Xerox's gross receipts (i.e., its gross income of every kind and from every source, including its gross proceeds

from goods manufactured in those states and sold in Washington), minus certain deductions permitted by statute, and multiplied by an apportionment factor. California's and New York's taxes are apportioned on the basis of a three-factor formula that compares Xerox's property, payroll, and sales in those states to its property, payroll, and sales everywhere. For goods Xerox manufactures in California or New York and sells in Washington, the property and payroll of Xerox's plant that produces those goods, its distribution centers, and its corporate and/or regional headquarters located in the manufacturing state are included in the numerator of that state's property and payroll factors, respectively.

13. Xerox borrowed and invested funds during the years 1980 through 1984 in the generally available money markets. Xerox's experience with respect to the cost of borrowing money and its return on invested money reflected the prevailing market rates of interest.

14. No claims for refund are made by Xerox in this action on behalf of any corporation that is or has been a subsidiary or affiliate of Xerox. This stipulation is not a waiver of any such claims and is without prejudice to any right any past or present Xerox subsidiary or affiliate corporation may have to seek such relief in a separate action.

KENNETH O.
EIKENBERRY
Attorney General
State of Washington

/s/ William B. Collins
William B. Collins
Assistant Attorney General
Attorneys for Defendant

BOGLE & GATES
/s/ D. Michael Young
D. Michael Young
Attorneys for Plaintiff

AFFIDAVIT OF GARY O'NEIL
 IN THE SUPERIOR COURT OF WASHINGTON
 FOR THURSTON COUNTY

NO. 84-2-01900-7

NATIONAL CAN CORPORATION,
 Plaintiff,
 vs.

STATE OF WASHINGTON,
 DEPARTMENT OF REVENUE,
 Defendant.

NO. 84-2-01916-3
 XEROX CORPORATION,
 Plaintiff,
 vs.

STATE OF WASHINGTON,
 DEPARTMENT OF REVENUE,
 Defendant.

NO. 84-2-01891-4
 KALAMA CHEMICAL, INC.,
 Plaintiff,
 vs.

STATE OF WASHINGTON,
 DEPARTMENT OF REVENUE,
 Defendant.

AFFIDAVIT OF GARY O'NEIL

KENNETH O. EIKENBERRY,
 ATTORNEY GENERAL

William B. Collins
 Assistant Attorney General
 415 General Admin. Bldg., AX-02
 Olympia, WA 98504 (206) 753-5528

STATE OF WASHINGTON)
) ss.
 County of Thurston)

GARY O'NEIL, being duly sworn on oath, says:

1. *IDENTIFICATION.*

I am the Assistant Director of the Washington State Department of Revenue for Research and Information and have acted in that capacity since 1977.

2. *RESEARCH AND INFORMATION DIVISION.*

The duties of the Research and Information Division include the compilation of statistical information with respect to the tax laws of the state and their administration. Prior to July 1, 1984 the Research and Information Division was charged with the responsibility of making revenue forecasts. After July 1, 1984 this became the responsibility of the Economic and Revenue Forecast Council. The Research and Information Division continues to supply technical assistance to the Council. The Research and Information Division is also responsible for preparing Fiscal Notes for the legislature describing the fiscal impact of proposed legislation.

3. *FIRST PURPOSE OF AFFIDAVIT PARAGRAPHS 3-9.5.*

The first purpose of this affidavit is to estimate the potential tax refund liability to all affected taxpayers that would be incurred by the State of Washington for the years 1980 through 1984 in the event of a decision in favor of the taxpayer in this action and in the two related cases before this Court for hearing. In the development of the estimates set forth in this affidavit I have been assisted

by counsel assigned to the Department as well as by employees of the Department in the Research and Information Division, the Excise Tax Division, and the Information Systems Section of the Department of Revenue.

4. SEPARATE ESTIMATES FOR MANUFACTURING AND SELLING B&O TAX.

I have been informed by counsel for the Department of Revenue in this action that claims in litigation allege that Washington's extracting and manufacturing B&O tax on Washington's extractors and manufacturers selling products so extracted or manufactured in interstate commerce is unconstitutional. Other claims in litigation allege that Washington's selling (wholesaling and retailing) B&O tax, imposed on those manufacturing products outside of Washington and selling them within this state, is unconstitutional.

The estimates in this affidavit are separately set forth for the manufacturing B&O tax and the selling B&O tax, and are based on the information and assumptions more fully explained below.

5. INITIAL REVENUE ESTIMATES AND PURPOSE.

After the decision of the U.S. Supreme Court in *Armco, Inc. v. Hardesty*, — U.S. —, 81 L.Ed.2d 540, 104 S.Ct. 2620 (1984) the Department of Revenue was asked to determine the extent of potential liability to the State of Washington if (a) Washington's manufacturing B&O tax was invalidated as applied to Washington manufacturers selling products in interstate and foreign commerce and (b) Washington's selling B&O tax was invalidated

as applied to out-of-state manufacturers selling products in the State of Washington.

These estimates of tax refund liabilities were set forth by the State of Washington in its Preliminary Official Statement, dated January 25, 1985, accompanying the issuance of the State of Washington general obligation refunding bonds (Series 1985AO).

Revised estimates of tax refund liability are set forth in paragraphs 6, 7 and 8 below, with accompanying explanations for derivation of the estimates.

6. POTENTIAL REFUNDS TO CURRENT CLAIMANTS.

<u>6.1 Washington Manufacturers—Actual Claims</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>Total</u>
6.1(A) Amounts claimed by taxpayers filing for 1980 only (adjusted and subject to the assumptions as described in subparagraph. 6.3)					\$ 10,908,841	
6.1(B) Amounts claimed by taxpayers filing for 1980 and subsequent years (adjusted and subject to the assumptions as described in subparagraph. 6.3)						

197

described in subparagraph. 6.3)	\$ 10,908,841	—	—	—	\$ 10,908,841
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6.2 Out-of-State Manufacturers—Actual Claims

6.2(A) Amounts claimed by taxpayers filing for 1980 only (adjusted and subject to the assumptions as

described in subparagraph. 6.3)	685,597	—	—	—	685,597
6.2(B) Amounts claimed by taxpayers filing for 1980 and subsequent years (adjusted and subject to the assumptions as described in subparagraph. 6.3)					
Interest (computed through Dec. 31, 1985)	4,532,312	4,637,124	4,838,434	7,623,175	7,764,462
CURRENT TAX REFUND CLAIMS					

198

96,411,985
8,564,214
\$104,976,199

6.3 Assumptions Underlying 6.1 and 6.2.

6.3(A) A review of claims filed by persons seeking refunds, either administratively with the Department of Revenue or in litigation demonstrated a number of discrepancies between the amounts claimed and taxes paid during the period(s) for which refund was sought with regard to both Washington manufacturers and extracting B&O tax and selling B&O tax. Some claims were less than the amount of applicable taxes reported to the Department. The great majority of discrepancies, however, in number and amount, represented claims in excess of the amounts of taxes reported. Analysis of the discrepancies suggests that such differences may be attributable to (a) careless or deliberate overstatement of claims at year-end to avoid understatement that would prevent subsequent refund for the full amount to which a taxpayer might be legally entitled, (b) failure to report the amount on the proper line of the Combined Excise Tax Return (e.g., manufacturing tax reported on wholesaling line of return), and (c) failure to reduce amounts of taxes shown to have been paid on the manufacturing, wholesaling or retailing reporting lines by credits taken for inventory taxes paid or pollution equipment installed.

6.3(B) These figures also assume the right to refund of the amounts so claimed is attributable to the issues in this litigation and not to other causes.

7. *PROJECTED REFUNDS TO CURRENT CLAIMANTS* (including those claiming for 1980 only or 1980 and one or more, but not all of years at issue).

7.1 Washington Manufacturers.

	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>Total</u>
Amounts subject to claims by taxpayers who have currently filed refund claims. Potential claims for subsequent years are based on amounts of taxes adjusted as described in subpar. 7.3)	9,407,102	8,901,827	10,644,297	16,011,579	44,964,805
Interest Computed to Dec. 31, 1985					\$47,624,500
TOTAL REFUND CLAIM POTENTIAL					3,243,577
					\$50,868,077

7.3 Adjustment and Assumptions Underlying 7.1 and 7.2.

7.3(A) "Amounts of taxes actually paid" include reductions for inventory tax credits and pollution equipment credits.

7.3(B) Taxpayers who have filed either administrative claims with the Department of Revenue or claims in litigation with respect to the year 1980 will amend existing claims to add claims for the subsequent years 1981-84.

8. ESTIMATES OF TAX REFUNDS FOR TAX-PAYERS NOT CURRENTLY CLAIMING REFUND.

8.1 Washington Manufacturers

	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	Total
Amounts subject to tax refund claim by taxpayers who have not yet filed claims for refund (as determined by methodology set forth in subpar. 8.4)	26,504,153	23,238,285	36,894,079	49,775,578	\$136,412,097

8.2 Out-of-State Manufacturers

	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	Total
Amounts subject to tax refund claim by taxpayers who have not yet filed claims for refund (as determined by methodology set forth in subpar. 8.5)	30,431,767	31,975,626	39,616,532	41,253,185	143,277,110

Interest Computed to Dec. 31, 1985

TOTAL REFUND CLAIM POTENTIAL

8.3 Assumptions Underlying 8.1 and 8.2

(A) Other taxpayers who have not yet filed tax refund claims for taxable years still open under the statute of limitations will file such claims beginning with the taxable year 1981.

(B) All amounts set forth in tax returns and used in deriving these estimates would be recoverable under the issues in this litigation (this assumption also underlies subpar. 7.1 and 7.2).

(C) For purposes of estimating claims by out-of-state manufacturers, 1983 was used as a representative year. (See subpar. 8.5(C), *infra*.)

8.4 Methodology for Estimates for Washington Manufacturers

The Department of Revenue has estimated a potential tax refund liability of Washington manufacturing tax by taking amounts paid for manufacturing B&O tax set forth in the Quarterly Business Review, a publication of the State of Washington. The Quarterly Business Review is a standard report issued by the Research and Information Division of the Department which summarizes manufacturing B&O tax reported to the Department each calendar quarter by individual manufacturers. The Department did not include the Quarterly Business Review figures for extracting B&O tax. Credits for inventory tax and pollution control equipment were then subtracted from these amounts. On the basis of such information, the Department estimated the potential manufacturing B&O tax refund liability for all taxpayers (including those identified in subpar. 6.1 and 7.1) as follows:

1980	\$ 40,900,000
1981	45,200,000
1982	41,700,000
1983	59,500,000
1984	81,800,000
	<hr/>
	\$269,100,000

The amounts set forth in subpar. 6.1 and 7.1 have been subtracted from these amounts to derive the estimates set forth in subpar. 8.1.

8.5 Methodology for Out-of-State Manufacturers

The Department of Revenue estimated the potential tax refund liability of Washington selling B&O tax on out-of-state manufacturers selling within Washington (including taxpayers identified in subpar. 6.2 and 7.2).

(A) Taxpayers classified as wholesalers doing business in Washington but having a business address outside Washington were identified from a data base maintained by the Information System Section of the Department. Those companies classified as retailers were disregarded.

(B) The list of taxpayers was supplied by the Research and Information Division to the Excise Tax Division which determined which of such taxpayers engaged in actual manufacturing outside of Washington.

(C) The Research and Information Division then determined the total wholesaling and retailing B&O tax paid by this group of taxpayers so identified. To this figure was added the wholesaling and retailing B&O tax paid by taxpayers actually registered with the Department as out-of-state manufacturers. This latter figure was taken from

the Quarterly Business Review. The sum of the two figures for 1983, the last year for which the Department has complete figures, was found to be \$53,000,000. This amount was rounded down to \$50,000,000, which represents the projected potential refund liability of wholesaling and retailing B&O tax for 1983.

(D) To calculate the wholesaling and retailing B&O tax for 1980, 1981, 1982 and 1984 the Research and Information Division applied a factor to the 1983 base figure of \$50,000,000. The factor was the relationship of the actual, entire wholesaling tax reported in 1981 by registered out-of-state manufacturers as shown in the Quarterly Business Review divided by the actual wholesaling tax reported in that publication for 1983. A similar factor was developed for 1980, 1982 and 1984.

(E) On the basis of the foregoing calculations the Department has estimated the potential selling B&O tax refund liability (including taxpayers previously identified in subpar. 6.2 and 7.2) as follows:

1980	\$ 33,700,000
1981	35,700,000
1982	37,400,000
1983	48,000,000
1984	49,700,000
	<hr/>
	\$204,500,000

The amounts derived in this subparagraph (E) are overstated for the reason that (1) a number of taxpayers whose principal places of business are outside of Washington nevertheless maintain manufacturing facilities in Washington from which products are sold within the state;

and (2) no exclusion has been made for amounts paid on selling activities of products *not* manufactured by these taxpayers. The validity of the taxes attributable to such sales is not in issue in this litigation but is reflected in the amounts shown in this subparagraph (E). The portion of such amounts attributable to intrastate sales in Washington cannot be determined without audits of individual taxpayers.

(F) The amounts set forth in subpar. 6.2 and 7.2 have been subtracted from the amounts set forth in (E) above to derive the estimates set forth in subpar. 8.2.

9. ESTIMATED ACTUAL AND PROJECTED POTENTIAL TAX REFUND LIABILITY.

9.1 Washington Manufacturers

(A) Actual claims for 1980 and other years (subpar. 6.1)	\$ 66,330,881
(B) Projected claims by 1980 claimants for subsequent years (subpar. 7.1)	44,964,805
(C) Projected claims by potential claimants (subpar. 8.1)	<u>136,412,097</u>
	\$247,707,783

9.2 Out-of-State Manufacturers

(A) Actual claims for 1980 and other years (subpar. 6.2)	30,081,104
(B) Projected claims by 1980 claimants for subsequent years (subpar. 7.2)	2,659,695
(C) Projected claims by potential claimants (subpar. 8.2)	<u>143,277,110</u>
	176,017,909
POTENTIAL CLAIMS (exclusive of interest)	<u>\$423,725,692</u>

9.3 OTHER CALCULATIONS (Interest Payable on Refunds).

I have been advised by counsel for the Department of Revenue that taxpayers in the three related cases before this Court for hearing have placed in issue the validity of the interest currently paid to taxpayers upon refund of taxes determined to have been overpaid. The calculation of interest on potential tax refunds set forth in paragraphs 6, 7 and 8 below has been made at the existing statutory rate (3%) and computed as if owing from the final day of each calendar year for which a refund might be due.

10. SECOND PURPOSE OF AFFIDAVIT PARAGRAPHS 10-13.

Under Washington's business and occupation (B&O) tax as confirmed by counsel assigned to advise the Department, manufacturers in Washington who sell their products at retail or wholesale in Washington pay a B&O tax on the selling activity. RCW 82.04.440 provides an exemption from the manufacturing B&O tax for those who pay tax on their selling activity, except with respect to products manufactured for their own use. The second purpose of this affidavit is to set forth the manufacturing B&O tax such manufacturers would have paid if RCW 82.04.440 did not provide an exemption for tax on the manufacturing activity.

11. ESTIMATE OF MANUFACTURING TAX ATTRIBUTABLE TO RCW 82.04.440.

The Department estimates that the manufacturing tax attributable to the exemption in RCW 82.04.440, based on 1983 returns filed by Washington manufacturers selling at the wholesaling and retailing level within the state,

would be approximately \$44 million. The manufacturing tax attributable to RCW 82.04.440 for first six months of 1984 \$17 million or \$34 million on an annualized basis.

12. EVALUATION OF MANUFACTURING TAX ESTIMATES.

The amounts set forth in paragraph 11 are overstated for the same reason taxes are overstated in subparagraph 8.5(E) (p. 11). The information utilized by the Department in its estimates does not identify those Washington manufacturers with manufacturing facilities outside the state which sell products from those locations in Washington. Such sales would be reported on the wholesaling or retailing line of the Combined Excise Tax return, which has been used as the measure of the tax payable shown in paragraph 5. The identification of such out-of-state facilities and the sales in Washington attributable to those locations would require individual audit of the taxpayers; such information is not otherwise available to the Department.

13. METHODOLOGY FOR ESTIMATING MANUFACTURING TAX IN PARAGRAPH 11.

These estimates of the manufacturing B&O tax set forth in the preceding paragraph have been derived by the Research and Information Division under my instruction and supervision in the following manner:

(A) Washington manufacturers registered with the Department of Revenue under the major manufacturing groups, set forth in the Standard Industrial Classification ("SIC") Manual, were first identified. A copy of such major group listing is attached as *Schedule A* to this affidavit. Excepted from the Department's computation was major group 21 "Tobacco Manufacturers", there being no such registered taxpayers in this state.

(B) The data base maintained by the Department for taxpayers classified by major manufacturing SIC group permits the Department to compile information concerning taxes paid annually either (i) by individual manufacturer or (ii) by all manufacturers under each major SIC group, by aggregating the amounts reported by Washington manufacturers on the appropriate lines of the Combined Excise Tax return, filed by taxpayers, with respect to such manufacturers' selling activities at the wholesale and retail level. A copy of the Washington Combined Excise Tax return is attached as *Schedule B*.

(C) The taxable base against which the manufacturing B&O tax was applied for 1983 and for the first six months of 1984 by Standard Industrial Classification code is set forth in *Schedule C* of this affidavit together with the computation of tax derived by applying the manufacturing B&O tax rate to such base.

(D) At the time of these computations the Department of Revenue did not have entered in its data base taxes paid by Washington manufacturers for the final two calendar quarters of 1984. The Department at the time of this affidavit is completing that part of its internal audit which adjusts for mathematical errors shown on returns filed by taxpayers for the final two quarters of 1984.

/s/ Gary O'Neil

SUBSCRIBED AND SWORN TO before me this 20th day of May, 1985.

/s/ Sharon L. McCall

NOTARY PUBLIC in and for the State of Washington,
residing at Olympia.

AFFIDAVIT OF DANIEL KELLER

[Filed July 19, 1985]

IN THE SUPERIOR COURT OF
WASHINGTON FOR THURSTON COUNTY
NO. 84-2-01900-7

NATIONAL CAN CORPORATION,
Plaintiff,
vs.

STATE OF WASHINGTON,
DEPARTMENT OF REVENUE,
Defendant.
NO. 84-2-01916-3

XEROX CORPORATION,
Plaintiff,
vs.

STATE OF WASHINGTON,
DEPARTMENT OF REVENUE,
Defendant.
NO. 84-2-01891-4

KALAMA CHEMICAL, INC.,
Plaintiff,
vs.

STATE OF WASHINGTON,
DEPARTMENT OF REVENUE,
Defendant.
AFFIDAVIT OF DANIEL KELLER

Kenneth O. Eikenberry, Attorney General
William B. Collins
Assistant Attorney General
415 General Admin. Bldg., AX-02
Olympia WA 98504 (206) 753-5528
....., Wa.

STATE OF WASHINGTON)
County of Thurston) ss.
)

DANIEL KELLER, being first duly sworn upon oath,
deposes and says:

1. IDENTIFICATION.

I am currently employed by the State of Washington as acting Assistant Director for the Budget Division of the Office of Financial Management, having served also as Senior Executive Policy Coordinator in that division.

I have been with the Office of Financial Management since 1967 and have held the position of Senior Executive Policy Coordinator since 1977. From 1967 to 1977 my principal responsibilities were as budget analyst/budget coordinator for all natural resource functions of state government, and from 1971 to 1976 I also worked on compensation issues such as salary and benefits.

From 1962 to 1967 I was a budget analyst with the Federal Bureau of Reclamation, providing budget analysis for irrigation project construction and operations.

I received my Bachelor of Arts degree in finance from the University of Washington. I have done some graduate studies in finance and accounting toward a Masters degree in business administration.

2. BUDGET AND POLICY DIVISION.

The Budget Division of the Office of Financial Management is the principal central financial entity for all of state government providing budget and financial advice and recommendations to the Governor, developing the Governor's budget proposals to the legislature, providing the support to explain the budget proposals, and providing other statewide financial data to both the legislature and the public. My responsibilities include determining the cost and making recommendations concerning budget proposals that have impacts across state agency lines such as salary increases, benefit increases, pension funding, and state debt service. I am also responsible for developing the tables indicating the current and projected financial status of the state general fund and all other funds under various alternative conditions at any time. In the past I have also been responsible for coordinating the revenue portion of the same budget.

3. PURPOSE OF AFFIDAVIT.

The purpose of this affidavit is threefold:

3.1 To describe the fiscal situation of the State of Washington during the period in which the budget for the July 1, 1985 - June 30, 1987 biennium was under consideration by the legislature and enacted into law.

3.2 To describe with reference to the budget document enacted into law and related documents introduced in this cause as exhibits certain details in the 1985-87 biennial budget including provisions dealing with appropriations (or their absence for the second fiscal year of the biennium (July 1, 1986 - June 30, 1987)), and

3.3 To (i) describe and to quantify possible reductions in amounts appropriated by the legislature for the 1985-87 biennium and the program impacts of such reductions, in the event the State of Washington were required to pay during the biennium as the result of the litigation in this cause tax refunds for the period 1980-84 that approximate \$424 million, and (ii) identify other sources of payment for such liabilities.

4. STATE BUDGET 1985-87 BIENNIUM.

4.1 The biennial budget described in this affidavit, except where otherwise indicated, is the "general fund budget". The general fund budget is that part of the total state budget which provides for the operations of most state agencies including the delivery of social services and production of natural resources and providing a major portion of the appropriations for the state's common schools (K-12) and its other educational facilities including community colleges and the state universities. Revenues contributing to the general fund budget include the state's business and occupation tax, retail sales and use taxes, certain other taxes and a certain number of federal grants.

4.2 The total state budget for the biennium, of which the general fund budget is a part, also includes specially dedicated revenues which are more particularly described in subparagraphs 4.8 and 8.4 herein.

4.3 In December, 1984 the then outgoing Governor, John Spellman, submitted to the legislature a proposed general fund budget for the 1985-87 biennium, as required by law, projecting state general fund revenues at \$9,646,439,000. Proposed revisions to the 1985-87 operating budget were then submitted to the legislature by incoming Gov-

ernor Booth Gardner showing a revised projection of state general fund revenues in the amount of \$9,624,796,000.

4.4 In March 1984 the State's Economic and Revenue Forecast Council projected a decline in general fund revenues for the 1985-87 biennium of \$153,000,000, reducing estimates to a level of \$9,493,000,000.

4.5 In June 1985 further revisions of projected general fund revenues for the 1985-87 biennium by the Economic and Revenue Forecast Council indicated a further reduction in such revenues in the magnitude of \$221,300,000, thereby lowering anticipated general fund revenues for the biennium to a level of \$9,271,700,000. This projection was subsequently adjusted to \$9,313,000,000 at the time of adoption of the 1985-87 biennial budget.

4.6 The continued reduction in estimates of general fund revenues has reflected the reliance of the state's tax structure on sales taxes for a major portion of such general fund revenues at a time when the projected level of consumption of goods and services in the State of Washington has been declining and the State's unemployment rate has exceeded that of the national average.

4.7 The uncertainty in the general fund revenue forecast caused by the anticipated June 1985 revisions caused adjournment of the legislature in May without the passage of a budget for the 1985-87 biennium. The legislature reconvened in special session on June 10 and adopted the state budget for the 1985-87 biennium.

4.8 The total state budget for the 1985-87 biennium, including estimated federal funds of \$3.4 billion, is \$17.9 billion. Of that total, \$9.1 billion comes from the state general fund. Support for the broad based state general fund

comes from taxes including: sales and use, business and occupation, utility, property and various other excise taxes and an additional element of federal support. The balance of the state budget after reduction for federal funds (\$3.4 billion) and general fund revenues (\$9.3 billion) is \$5.2 billion, and is derived from other, non-general fund sources.

Revenues assignable to non-general fund sources include generally (1) certain tax revenues, most notably motor vehicle fuel taxes; (2) licenses, permits and fees—of which the largest single amount is comprised of motor vehicle licenses and fees; (3) other charges and miscellaneous revenue which incorporate proceeds of bond issues, tuitions and sales of services, materials and supplies. These categories of revenue are set forth more fully in Attachment A.

4.9 The projected surplus at the end of the 1985-87 biennium of \$173 million (represented by \$9,313 million of projected state general fund revenues in excess of general fund appropriations of \$9,140 million) must be evaluated in light of the following considerations:

- (a) Appropriations for the second year of the biennium, with few exceptions, contain no general adjustments over the first year for workload or caseload increases or for inflation. Inflation adjustments at the annual rate of 4.3 percent to maintain the same level of services in the second year of the biennium as provided in the first year would approximate \$50 million.
- (b) State general funds in the budget for public pension obligations is \$676 million or \$246 million below the state actuary's recommendation for current funding to avoid increasing the State's un-

funded liability obligation which now exceeds \$3.2 billion.

5. STATE PROGRAM REDUCTIONS.

5.1 In the event the State is required to issue tax refunds of the magnitude involved in this litigation, it must then confront the necessity of across-the-board reductions in all state programs. However, because of state constitutional requirements, the entire \$9.1 billion state general fund budget is not subject to reduction. The basic K-12 public school program is under constitutional protection; likewise revenues collected on behalf of and dedicated to local governments are free from reduction. These dollar amounts are as follows:

K-12 Public School	\$4.24 billion
Local Government Revenue	.21 billion
TOTAL	\$4.45 billion

5.2 With \$4.4 billion of the budget not subject to reduction, there remains only the balance of \$4.7 billion from the general fund portion of the budget which could be subject to reductions to raise the necessary revenue. Were an appellate court to order tax refunds as early as June 1986, one-half of the current biennium would have expired before any reduction program could be put in place leaving at most \$2.35 billion from which to take the necessary funds. A \$424 million reduction, taken from this budget balance, would represent approximately an 18 percent cut in all programs. With any state general fund reduction across the board, one-half would have to come from the human resource programs of the Department of Social and Health Services and

Department of Corrections. This means an 18 percent reduction in aid to the (a) 65,000 families receiving Aid to Dependent Children; (b) 310,000 persons who monthly receive Medical Assistance; (c) 16,000 persons receiving Nursing Home Care to the Aged; (d) institutional support to 4,000 mentally and physically handicapped persons; and (e) some 7,000 inmates currently in correction facilities.

5.3 Programs in state community colleges and higher education institutions currently serving some 80,000 and 69,000 enrollees respectively would likewise be impacted with an 18 percent across the board reduction in state support. Education and vocational training opportunities for many would have to be curtailed or eliminated.

5.4 Human resource programs and higher education make up 72 percent of the "unprotected" available budget. Selective reductions could not be made in the required amount, \$424 million, without significantly affecting any area. For instance, the entire Adult Correction Program budget for the biennium totals only \$323 million, which represents only three-fourths of the amount necessary to provide for the tax refund liability. Income maintenance of the so-called "welfare" program with Aid to Dependent Children receives a budget of \$437 million for the entire biennium. The Medical Assistance budget is \$438 million and Nursing Home Care budget is \$271 million.

5.5 Entire elimination of the community college system with its 80,000 students and 7,300 employees would provide \$481 million for the biennium, half of that amount over the second year of the biennium. Closing the University of Washington with its 30,000 students and 12,000 employees would release \$437 million over the full biennium or \$218 million in its second year.

6. STAFF CUTS.

The only remaining alternative of staffing reduction also has very severe consequences. \$424 million represents approximately 33 percent of the \$1,290 million biennial state general fund cost of classified staff in the State of Washington. With only one-half of the biennium left, the reduction would amount to an estimated 66 percent cut in all classified staff. (Classified staff includes merit (civil) service employees but excludes commissioned state patrol offices, faculty at community colleges and four-year universities, ferry service workers, and employees of the legislature and judicial branches.) If all employee jurisdictions were reduced including faculty, exempt personnel, state patrol, and all others, the staff reduction needed would still be approximately 38 percent.

7. TAX REFUNDS PAYABLE

The budget consequences described in paragraphs 5 and 6 pertain to estimated tax refunds for which the State of Washington might be liable for the tax years 1980-84, and do not take into account claims for refunds which might be attributable to 1985 or any subsequent year or portion thereof to the time of judgment adverse to the State. The budget consequences described in paragraphs 5 and 6 are also based on the anticipated General Fund Revenue for the 1985-87 biennium as projected by the Economic and Revenue Forecast Council (¶ 4.5).

8. QUALIFICATIONS TO DESCRIPTION OF STATE PROGRAM REDUCTIONS.

8.1 The program reductions hypothesized in paragraphs 5 and 6 represent the type of state budget adjust-

ments that would be required upon the occurrence of other adverse economic events of comparable dimension such as fluctuations in the economic cycle thereby resulting in a decrease in budget revenues.

8.2 Moreover, the explanation of expenditure impacts in paragraphs 5 and 6 above do not take into account the possible availability of the budget surplus in the 1985-87 biennial budget, additional taxes that might be enacted by the legislature from alternative tax sources, or increased revenues from an improved economy.

8.3 At the request of plaintiffs' counsel I have made alternative calculations showing the impact of tax refunds of varying amounts on state programs and staff. These are shown in Attachment B. Like the figures in paragraphs 5 and 6 the amounts in Attachment B do not take into account budgeted surplus or increased revenues from additional taxes or diversions of non-general fund revenues into the general fund. Attachment B shows for example that if refunds were made in the amount of \$50 million in the 1987-89 biennium and spread across the board, the percentage decreases in program (including human services, corrections and education other than K-12) and the related staff cuts would be:

PROGRAM REDUCTIONS	STAFF CUTS
0.5%	1.1%

8.4 (a) The reductions in state programs from state general fund revenues, discussed in paragraphs 5 and 6, do not take into account the possible availability of non-general fund revenues in the state budget. Certain of these

revenues could be redirected by the legislature either under current law or by subsequent legislative change.

(b) By the same token, however, certain revenues in the non-general fund portion of the state budget are constitutionally restricted to certain purposes or are otherwise limited to particular objects of expenditures. For example: (i) Amendment 18 to the Washington Constitution (Art. II, § 40) limits highway funds to use "exclusively for highway purposes". The Enabling Act by which the State of Washington was admitted into the Union restricts proceeds from timber and other natural resource sales to education purposes; (ii) Federal funds allocated to the State of Washington are restricted in their use to the particular purposes for which they are distributed; (iii) The use of the proceeds of bond issues for purposes other than for which the bonds are marketed are similarly limited.

(c) The availability of non-general fund revenues to legislative redirection or reappropriation (computed over the entire 1985-87 biennium) is represented as follows:

Non-General Fund Revenues (¶ 4.8)		\$ 5.2
less: constitutionally		
restricted revenues	\$1.7	
Proceeds of bond issues	1.1	
Debit Service	.7	3.5
—	—	
Non-General Fund Revenues subject to legislation appropriation		\$1.7 billion

The application of all or a portion of non-general fund revenues shown to be subject to redirection would have significant impacts, depending on the magnitude of their

redirection, on programs which include, for example, higher and community college education (tuitions), fish conservation (license fees), and alcoholic rehabilitation programs (liquor tax revenues). Of greater importance is the fact that many programs dependent on user fees for their continuation will simply cease to exist or will only continue in truncated form, if these revenues are diverted for the purpose of meeting tax refund liabilities.

I have read the above and believe the same to be true and correct to the best of my knowledge.

/s/ DANIEL KELLER

SUBSCRIBED AND SWORN TO before me this 18th day of July, 1985.

/s/ Shelley A. Sadie
NOTARY PUBLIC in and for the State of Washington, residing at Olympia.

ATTACHMENT A

<i>Non-General Fund Sources</i>	<i>Billions</i>
Motor Vehicle Fund	\$ 1.6
Bond Proceeds	1.1
Bond Payment Funds	.7
Trust Funds (like unemployment compensation and industrial insurance payments)	.2
Public School Construction Funds	.1
State Patrol Funds	.1
Ferry Operation Funds	.1
Liquor Board Funds	.1
Other: Including	1.2
Game Fund	
Highway Safety Fund	
Timber Management Fund	
Traffic Safety Fund	
Agricultural Inspection Funds	
Internal Support Funds	
TOTAL	\$ 5.2

ATTACHMENT B

POSSIBLE IMPACTS ON STAFFING AND PROGRAM LEVELS IF NO ADDITIONAL TAXES OR REVENUES

Assumed Reductions From Refunds or Revenue Declines or Other Reasons	SECOND YEAR OF 1985-87 BIENNIUM			1987-89 BIENNIUM (July 1, 1987 - June 30, 1989)		
	FISCAL YEAR 1987 (July 1, 1986 - June 30, 1987)	1985-87 Program Reductions	All ²	Combination Program Reduction/ Staff Cuts	1985-87 Program Reductions	All ²
	Staff Class. ¹	Cuts	Class.	Staff Cuts	Class.	Staff Cuts
\$ 50 Mil.	2.1%	7.7%	4.5%	Prog. Staff ²	1.1% 2.2%	3.9% 2.2%
\$100 Mil.	4.2%	15.5%	8.9%	Prog. Staff ²	2.1% 4.5%	7.7% 4.5%
\$150 Mil.	6.4%	23.2%	13.4%	Prog. Staff ²	3.2% 6.7%	11.6% 6.7%
\$200 Mil.	8.5%	31.0%	17.8%	Prog. Staff ²	4.2% 8.9%	15.5% 8.9%
\$250 Mil.	10.6%	38.7%	22.3%	Prog. Staff ²	5.3% 11.1%	19.4% 11.1%
\$424 Mil.	18.0%	65.7%	37.8%	Prog. Staff ²	9.0% 18.9%	32.9% 18.9%

¹ Classified staff includes merit system (civil service) employees but excludes commissioned state patrol officers, faculty at community colleges and four-year universities, ferry service workers and employees of the legislative and judicial branches.

² "All" staff includes classified employees and others not covered by merit system employment. Reference to "staff" under the column "Combination Program Reduction/Staff Cuts" means "all" staff.

221

222

FIRST STIPULATION RE: EXHIBITS
IN THE SUPERIOR COURT OF THE
STATE OF WASHINGTON
FOR THURSTON COUNTY

NO. 84-2-01900-7

NATIONAL CAN CORPORATION, et al.,

Plaintiffs,

vs.

STATE OF WASHINGTON,
DEPARTMENT OF REVENUE,

Defendant.

FIRST STIPULATION RE: EXHIBITS PERTAINING
TO WASHINGTON STATE BUDGET
AND REVENUES

THE PARTIES hereto stipulate that the following shall be admitted into evidence in this matter:

Exhibit Number	Exhibit Description
<i>Revenue Forecasts</i>	
1	1985-1987 Biennium — Revenue Forecast, Gary O'Neil, Director, Research and Information Division, Washington Department of Revenue, March 7, 1984.
2	1985-1987 Revenue Forecast -- Economic Alternatives, Gary O'Neil, Director, Research and Information Division, Washington Department of Revenue, July 6, 1984.

*Exhibit
Number*

Exhibit Description

- 3 General Fund Forecast 1983-1985 Biennium, September, 1984 Forecast compared to June, 1984 Forecast, Research and Information Division, Washington Department of Revenue, September 13 and 14, 1984.
- 4 1985-1987 Estimates, Donn Smallwood, Chief, Research and Statistics, Washington Department of Revenue, September 26, 1984.
- 5 Economic and Revenue Forecast for Washington State, Office of the Forecast Council, December, 1984.
- 6 Economic and Revenue Forecast for Washington State, Office of the Forecast Council, March, 1985.
- 7 Projected 1983-1985 Revenues and Expenditures, Senate Ways and Means Committee, April 30, 1985.
- 8 Selected pages from proposed Economic and Revenue Forecast for Washington State, Office of the Forecast Council, June, 1985.
- 9 Comparison of Projected 1985-1987 Revenues and Expenditures, Senate Ways and Means Committee, May 16, 1985.
- 10 Projected 1983-1985 Revenues and Expenditures, Senate Ways and Means Committee, May 20, 1985.
- 11 *Tax Alternatives*
- 11 Tax Alternatives, Research and Information Division, State of Washington, Department of Revenue, January 15, 1985.

*Exhibit
Number*

Exhibit Description

- 12 Tax Alternatives, Research and Information Division, Washington Department of Revenue, March 29, 1985.
- 13 Tax Alternatives, Research & Information Division, Department of Revenue, April 3, 1985.
- 14 *Tax and Spending Data*
- 14 1984 Tax Exemptions.
- 15 LEAP Budget Information Charts (3): Washington State, General Fund—State, Biennial Expenditures; Washington State LEAP Budgeting Report—Annual Comparison of TOT Washington State; and Washington State, General Fund—State, Biennial Expenditures—Constant Dollars Per Capita 1973-75 Through 1985-87.
- 16 Major Tax Rate and Base Reductions Since 1970—Estimated 1985-87 State and Local Impact—Graph and Narrative.
- 17 *Budget Data*
- 17 Cover and selected pages from Preliminary Official Statement, dated January 25, 1985, State of Washington, General Obligation Refunding Bonds, Series 1985A.
- 18 Cover and selected pages from Preliminary Official Statement, dated July 1, 1985, State of Washington General Obligation Bonds.

*Exhibit
Number*

Exhibit Description

19 Cover and selected pages from Proposed Revisions to the 1985-87 Operating Budget (State of Washington), Submitted by Governor Booth Gardner, March 1985.

Revenue Bills

20 Senate Bill Report of Engrossed Substitute Senate Bill No. 4228.

21 Draft fiscal note on ESSB 4228, Erling Johnson, Economic Analyst, Washington Department of Revenue, March 28, 1985.

22 Estimated Impact of ESSB 4228, Research and Information Division, Washington Department of Revenue, April 23, 1985.

23 Governor's veto letter regarding ESSB 4228 dated May 21, 1985.

24 Summary of Proposed Senate Bill No. 3677, Washington Department of Revenue, April 8, 1985.

25 Final Bill Report of Substitute Senate Bill No. 3678.

26 Governor's veto letter regarding SSB 3678 dated April 30, 1985.

Requests for Stay of Collection

27 Plaintiff's request for stay of collection of taxes at issue.

28 Denial of plaintiff's first request for stay of collection of taxes.

29 Plaintiff's second request for stay of collection of taxes at issue.

30 Denial of plaintiff's second request for stay of collection of taxes.

31 Brief of State of Washington as Amicus Curiae in Support of Appellee [West Virginia].

DATED this 19th day of July, 1985.

BOGLE & GATES
/s/ John T. Piper

KENNETH O. EIKENBERRY
Attorney General

/s/ William B. Collins
Assistant Attorney General

EXHIBIT 4

JOHN SPELLMAN (Seal) DONALD R. BURROWS

Governor

Director

STATE OF WASHINGTON
DEPARTMENT OF REVENUE

Date September 26, 1984

To Forecast Council

From Donn Smallwood, Chief, Research & Statistics

RE 1985-1987 Estimates

In response to Representative Grimm's request at the September 14 meeting, the attached table indicates the planning estimates for the 1985-1987 biennium that have been presented to the Council so far. All of the forecasts are based on the "control", or most probable, economic assumption scenario at the time the estimates were prepared.

DS:amd

Attachment

cc: Forecast Work Group

**EVOLUTION OF 1985-1987 PLANNING ESTIMATES
GENERAL FUND-STATE
(\$ MILLIONS)**

REVENUE BY SOURCE	Feb., 1984 Forecast	June, 1984 Forecast	Sept., 1984 Forecast
DEPARTMENT OF REVENUE			
RETAIL SALES	\$4,769.7	\$4,713.7	\$4,640.1
BUSINESS & OCCUPATION	1,721.3	1,684.0	1,658.9
USE	381.7	376.0	370.0
PUBLIC UTILITY	294.4	292.3	285.3
LIQUOR SALES	165.0	153.1	153.1
CIGARETTE PROPERTY (SCHOOLS)	188.5	188.5	195.1
	1,113.5	1,114.2	1,120.8

REAL ESTATE			
EXCISE	298.9	268.2	277.3
TIMBER REVENUE	41.8	44.3	38.6
OTHER	211.7	197.4	197.2
SUBTOTAL	9,186.5	9,031.7	8,936.4

DEPARTMENT OF LICENSING			
MOTOR VEHICLE			
EXCISE	418.3	428.8	425.6
OTHER	40.2	39.8	46.5
INSURANCE COMMISSIONER			

INSURANCE			
PREMIUMS	119.4	128.4	128.4
LIQUOR CONTROL BOARD			
EXCESS FUNDS			
& FEES	58.4	52.9	52.9
BEER & WINE			
SURTAX	3.0	3.0	3.0

LOTTERY COMMISSION			
LOTTERY REVENUE	265.0	213.3	213.3

STATE TREASURER			
INTEREST EARNINGS	51.1	51.9	51.9

OFFICE OF FINANCIAL MANAGEMENT			
DEBT SERVICE	(402.3)	(404.7)	(405.8)
TUITION	278.8	278.8	278.8

BUDGET			
STABILIZATION			
ACCOUNT TRANSFER			

OTHER	76.2	76.2	76.2
	_____	_____	_____

TOTAL GENERAL FUND-STATE	\$10,062.9	\$9,900.1	\$9,807.2
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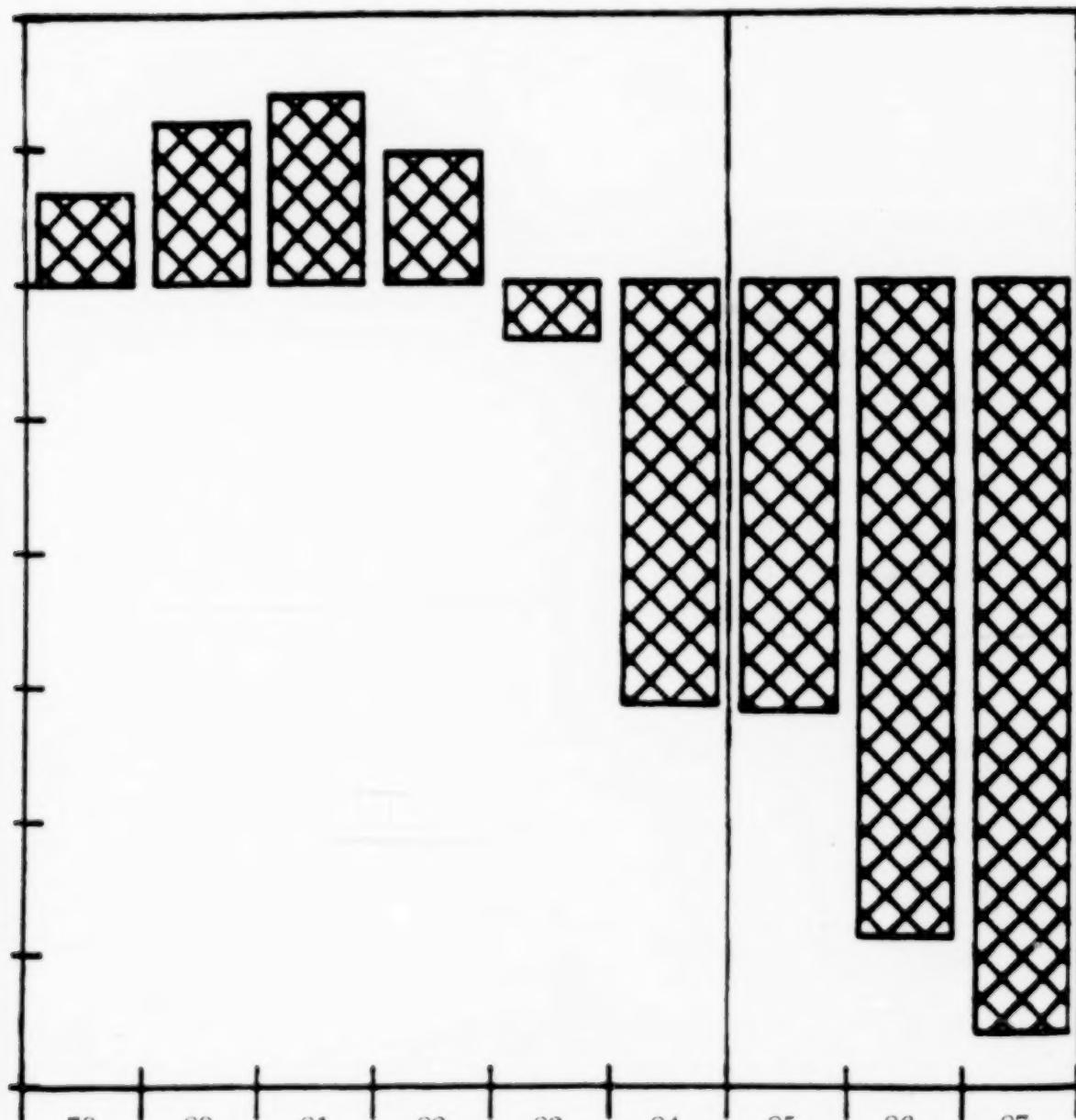
*CONTROL ESTIMATE

* * *

EXHIBIT 6

**ECONOMIC AND REVENUE
FORECAST**
For Washington State

U.S. TRADE DEFICIT: SLOWING THE ECONOMY



ECONOMIC AND REVENUE FORECAST COUNCIL

March 1985

(Seal)

STATE OF WASHINGTON
**ECONOMIC AND REVENUE
FORECAST FOR
WASHINGTON STATE**

Prepared by
Office of the Forecast Council

OLY.
March 1985

* * *

Preface

The Office of the Forecast Council is required by Chapter 138, Section 1, Laws of 1984 (RCW 82.01, 130) to prepare a quarterly state economic and revenue forecast and submit it to the Economic and Revenue Forecast Council.

The report presents the state's economic and General Fund revenues forecast and provides a background to policymakers for analyzing and planning in their decision-making processes. It is issued four times a year.

Single-copy subscriptions are available to the public free of charge. Mail requests for subscriptions or address changes to: Office of the Forecast Council, State of Washington, AX-02, Olympia, Washington 98504.

Dan McDonald, Chairman
Washington Economic and Revenue
Forecast Council

* * *

Alternative Forecasts

Two alternatives to the Washington State Baseline forecast have been prepared. The Pessimistic scenario calls for a recession during the 1985-87 biennium. In the Optimistic scenario, the current economic expansion continues through the next biennium.

In the Pessimistic scenario, the economy continues to grow during 1985. However, there is no action taken to reduce the federal budget deficit, and by the end of 1985 foreigners begin to reduce their investments in the U.S. The value of the dollar declines, and because of this and the growth of the economy, inflation begins to accelerate. The Federal Reserve is unable to accomodate this combination of strong economic growth and rising inflation, especially when there has been no action taken to reduce the budget deficit. Monetary policy is tightened, and this along with the falling dollar, increased inflation, and large budget deficits drives interest rates sharply higher. A recession occurs in fiscal 1987. The effect of this in Washington is a decline of 0.5 percent in real personal income in fiscal 1987, and a loss of 23,000 jobs. Interest rate sensitive sectors such as lumber and wood products and construction are the hardest hit. Interest rates and the recession have a drastic effect on housing activity in the state. The number of housing units authorized drops from over 31,000 in fiscal 1985 to less than 13,000 in 1987.

In contrast to the Pessimistic scenario, under the Optimistic assumptions everything goes right. Congress passes large budget cuts, and the dollar slides to a more competitive level; the decline is gradual enough to prevent a sharp rise in inflation. The impact of the lower dollar on inflation

is mitigated by OPEC's inability to hold the line on oil prices, which slip to \$25 per barrel. Continued low inflation and progress in cutting the deficit permit interest rates to fall, and the economy continues to expand through fiscal 1987. This scenario also implies a strong economy at the state level. Average annual increases in real income and employment are both above three percent during fiscal 1986 and 1987.

A combination of good economic policy and luck is required in the Optimistic scenario: it requires that the deficit be cut sharply; that the financial markets continue to respond to the low inflation rates, allowing interest rates to decline; and that foreign investors, money managers, and central banks take steps to allow the dollar to slide gradually to a more competitive level. Although each of these conditions taken individually is possible, the likelihood that they will all be achieved at once is relatively low.

* * *

Chapter II

Washington State Revenue Forecast

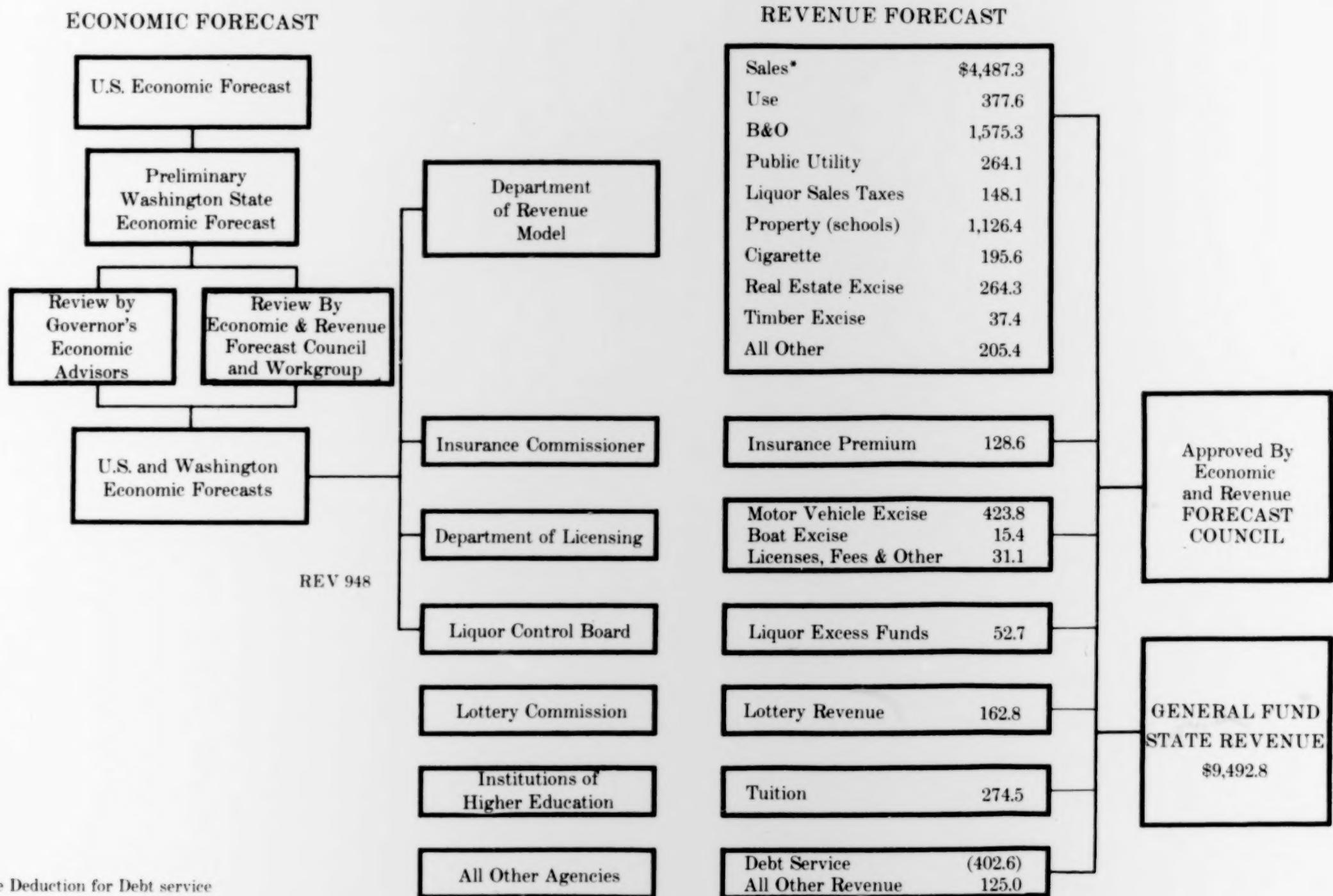
The State General Fund revenue forecast is reviewed and updated quarterly in conjunction with the revised state economic forecast. The March, 1985 forecast for both the 1983-85 and 1985-87 biennia were reviewed and approved by the economic and revenue forecast council, March 18, 1985. This council was created by Chapter 138, Laws of 1984 (RCW 82.01.130) to provide objective revenue estimates for both executive and legislative branches. The Council consists of six members, two appointed by the Gov-

ernor and two appointed by the legislature from each caucus of the Senate and House of Representatives. The members of the Economic and Revenue Forecast Council are listed on the inside front cover.

A flow chart of the forecast process including the March, 1985 baseline forecast for the 1985-87 biennium approved by the Forecast Council is shown in Figure 1.

Each state agency engaged in revenue collection is responsible for preparation of forecasts of its own sources. The staff of the forecast council is responsible for the preparation of the state economic forecast, the revenue forecast of the Department of Revenue's tax sources and the review and coordination of the revenue forecasts of other major revenue collecting agencies. The Office of Financial Management assumes the responsibility of coordinating the forecasts of the 100 or so small state agencies. The state economic forecast updated and reviewed by the Governor's Council of Economic Advisors, forms the basis for the forecast of major state taxes, especially the transaction based taxes such as the retail sales and business and occupation taxes.

FIGURE 1
ECONOMIC AND REVENUE FORECAST FLOW CHART
GENERAL FUND—STATE
1985-87 BIENNIUM
(Amounts in Millions)



*Before Deduction for Debt service

Forecast Change 1985-87

The March forecast for the 1985-87 biennium is \$153.6 million below the December, 1984 forecast. The majority of this change is in Department of Revenue sources (\$139.2 million) primarily the retail sales, use and business and occupation taxes. The 1985-87 forecast of other agencies was reduced \$14.4 million from the December forecast. Table II provides a comparison of the March and December forecasts for 1985-87 by agency. Table III presents the March, 1985 baseline forecast for 1985-87 by fiscal year and by major revenue source.

The primary factors contributing to the \$153.6 million reduction in the forecast for 1985-87 are: a lower base in the 1983-85 biennium, lower inflation than expected in December, a stronger real economy, which only partly offsets the negative impact of lower inflation, the expiration of the business and occupation surtax on retailing activity, and adjustments in the other agency revenues. These are summarized below.

Elements of Change

- Lower Base in 1983-85 (\$-46.8 million)
- Lower inflation (\$225.1 million)
- Stronger real growth (+160 million)
- Expiration of B&O retailing surtax (\$-27.3 million)
- Adjustments in the other agency revenues (\$-14.4 million)

TOTAL (\$-153.6 million)

Collection experience in the last few months of the 1983-85 biennium (October, 1984 - January, 1985 activity periods) indicates that revenues are about two percent below the level expected in December. This lower base is assumed to carry forward to 1985-87 and reduces the 1985-87 estimate by \$46.8 million.

The March, 1985 economic forecast assumes that inflation will be much less than expected in the December forecast. The overall price level is 2.3 percent below the December forecast and wholesale prices and the price levels of most consumer durables are 4-5 percent below the level expected in December. The impact of inflation reduces the 1985-87 forecast by an estimated \$225.1 million. The March forecast for the real economy is stronger than anticipated in December, offsetting part of the negative impact of lower inflation on revenues. Real personal income is 2.3 percent above the December forecast and employment levels are 1.6 percent higher than December. Overall the lower inflation and the lower base more than offset the improved real economy.

The 1985-87 biennium forecast has been reduced by an additional \$27.3 million because the business and occupation seven percent surtax on retailing activity is assumed to expire June 30, 1985 under current law. (See assumptions section).

Other agencies reduced their forecasts for 1985-87 by \$14.1 million. Positive adjustments for interest earnings, liquor profits, tuition and debt service were more than offset by lower projections for lottery and motor vehicle excise tax revenue.

The State Treasurer's forecast for interest earnings for 1985-87 was increased by \$4.3 million. This increase is

based upon a revised assumption that the average daily investible balance will be at approximately the current level. The tuition forecast is \$4.0 million higher than the December forecast due to technical adjustments. The liquor profits forecast is \$2.5 million above December's forecast. The Liquor Board assumes a decrease in sales of about 3 percent below the fiscal 1985 level and an increase in profits of about \$1.5 per 750 ML of spirits, due to the increase in the Federal excise tax on liquor scheduled October, 1985. The debt service requirements for 1985-87 were reduced by \$8.4 million. This saving reflects a decrease in bond sales and interest rates from what was expected in December.

The Department of Licensing reduced their forecast for motor vehicle excise tax by \$0.9 million per year for 1985-87. This is a very small adjustment (less than 0.5 percent) and primarily reflects current experience. The most significant change for other agencies was the lottery estimate. The lottery's forecast was reduced by \$34 million for 1985-87. The on-line sales forecast (lotto) was actually increased by \$10.4 million however, this was more than offset by a \$44.4 million reduction in the instant games forecast.

Alternative Forecast: 1985-87

Two alternative revenue forecasts for state General Fund revenues were prepared: one based on a more optimistic economic scenario than the baseline economic forecast and one assuming a more pessimistic outlook.

Under the optimistic scenario everything goes right for the economy. Real growth for both the nation and Washington State is strong, interest rates fall and inflation is moderate. The pessimistic scenario assumes that interest rates move higher and the economy slips into a recession in 1986. The

summary of the economic forecast in Chapter I provides more detail for these scenarios.

Table IV shows the revenue implications of the optimistic and pessimistic economic forecasts. The optimistic scenario generates \$9,948.3 million during the 1985-87 biennium. This is \$455.5 million above the baseline forecast. Under the pessimistic alternative, General Fund state revenues total \$9,054.3 million in the 1985-87 biennium this is \$438.5 million below the baseline forecast.

* * *

Table IV
March, 1985 Alternative Forecasts Compared
to March, 1985 Baseline Forecast
1985-87 Biennium
(\$ Millions)

Agency/Source	March, 1985		
	Optimistic Forecast	Baseline Forecast*	Pessimistic Forecast
Department of Revenue			
Retail Sales	\$ 4,727.8	\$ 4,487.3	\$ 4,241.1
Business and Occupation	1,611.6	1,575.3	1,527.9
Use	407.2	377.6	352.4
Public Utility	265.3	264.1	260.4
Real Estate Excise	357.7	264.3	184.6
Property	1,132.7	1,126.4	1,120.1
Other	605.0	586.5	569.1
Subtotal	\$ 9,107.3	\$ 8,681.5	\$ 8,255.6
Department of Licensing	483.3	470.3	457.7
Insurance Commissioner ¹	128.6	128.6	128.6
Lottery Commission	180.0	162.8	155.0
Treasurer Interest Earnings	38.1	56.2	76.9
Liquor Profit/Fees ²	57.3	55.6	54.0
Office of Financial Management			
Debt Service	(396.9)	(402.6)	(403.4)
Tuition	281.1	274.5	267.7
Other	69.5	65.9	62.2
TOTAL			
General Fund-State	\$9,948.3	\$9,492.8	\$9,054.3
Difference from Baseline	\$455.5	\$ -438.5

¹Insurance Premiums

²Includes Beer/Wine Surtax

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* * *

EXHIBIT 8

Table I

General Fund State Revenue
 Comparison of June, 1985 Forecast to March 18, 1985
 Forecast 1985-87 Biennium
 (Amounts in Millions)

Agency	March 18, 1985 ¹	June, 1985 ²	Difference
Department of Revenue	\$ 8,681.5	\$ 8,438.6	\$ -242.9
Other Agencies	811.3	832.8	21.5
Total General Fund*	\$ 9,492.8	\$ 9,271.5	\$ -221.3

¹Approved by the Economic and Revenue Forecast Council, March 18, 1985.

²Based on current law. Includes impact of legislation enacted during the 1985 regular legislative session.

*Detail may not add due to rounding.

Office of the Forecast Council

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05-29-85

Table II

Department of Revenue General Fund Forecast
 1985-87 Biennium
 June, 1985 Forecast Compared to March, 1985 Forecast
 \$000

Source	March, 1985 Forecast-#1	Legislative Adj-#2	Forecast Change	June, 1985 Forecast	Total Change
Retail Sales	\$4,487.3	(\$ 5.2)	(\$179.7)	\$4,302.4	(\$184.9)
Business & Occupation Use	1,575.3	9.4	(59.1)	1,525.7	(\$50)
Public Utility	377.6	(0.3)	(2.7)	374.6	(\$3)
Tobacco Product	264.1	8.0	23.7	295.9	\$32
Conveyance	11.8		0.4	12.1	\$0
Penalty & Interest	23.7		(1.1)	22.5	(\$1)
Revenue Act Subtotal	53.8		(0.3)	53.5	(\$0)
Liquor	\$6,793.6	\$11.9	(\$218.9)	\$6,586.6	(\$207.0)
HUD Privilege	148.1		(7.1)	141.0	(7.1)
Cigarette Property (Schools)	41.6		1.0	42.6	1.0
Other Property	195.6		0.0	195.6	0.0
Inheritance/ Estate	1,126.4		0.0	1,126.4	0.0
Leasehold	12.8		(.0)	12.8	(.0)
Fish	23.4		0.0	23.4	0.0
Real Estate Excise	15.5		(0.2)	15.3	(0.2)
Public Timber	4.3	(0.4)	(.0)	3.9	(0.4)
Other	264.3		(30.7)	233.6	(30.7)
On Revenue Act Subtotal	0.0	(0.4)	(35.6)	0.0	(35.9)
Private/Public Timber Distributions	18.6		1.3	20.0	1.3
Total General Fund Impact	37.4		\$0	37.4	\$0
	\$8,681.6	\$11.5	(\$254.4)	\$8,438.6	(\$242.9)

¹Approved by the Forecast Council March 18, 1985.

²Legislation enacted during the 1985 regular Legislative session.

Office of Forecast Council

Department of Revenue

31-May-85

* * *

Table II

General Fund State Revenue—Other Agencies
 Comparison of June, 1985 Forecast to March 18, 1985 Forecast
 1985-87 Biennium
 (Amounts in Millions)

Source/Agency	March 18, 1985 Legislative Forecast		June, 1985 Total Forecast Changes		Baseline Changes
	Forecast	Changes	1985 Forecast	Changes	
Department of Licensing					
Motor Vehicle	\$423.8	—	9.4	433.2	9.4
Other	46.5	1.1	-.1	47.5	1.0
Insurance Commissioner					
Insurance Premiums	128.6	—	2.1	130.7	2.1
Liquor Control Board					
Liquor Profits and Fees	52.7	—	-3.0	49.7	-3.0
Beer & Wine Surtax	2.9	—	—	2.9	—
Lottery Commission					
Lottery Revenue	162.8	—	—	162.8	—
State Treasurer					
Interest Earnings	56.2	—	-2.4	53.8	-2.4
Office of Financial Management					
Debt Service	(402.6)	—	10.5	(392.1)	10.5
Tuition	274.5	—	-9.5	265.0	-9.5
Budget Stabilization Account Transfer	—	—	—	—	—
Other	65.9	1.4	11.9	79.2	13.3
Total General Fund—State	\$811.3	2.5	19.0	832.8	21.5

*Detail may not add due to rounding.

Office of the Forecast Council
 50510N1
 05-29-85

* * *

Table 1

General Fund State Revenue
 Comparison of June, 1985 Baseline with Alternatives
 1985-87 Biennium
 \$ Millions

Agency	Optimistic	Baseline	Pessimistic
Department of Revenue	\$8,817.2	\$8,438.6	\$7,959.4
Other Agencies	869.1	832.8	782.9
TOTAL General Fund	\$9,686.3	\$9,271.5	\$8,742.3
Difference from Baseline	\$ 414.5	—	\$ -529.2
Difference from March 18, 1985	\$ 193.5	\$ -221.3	\$ -750.5
Office of the Forecast Council 850510R1 05-30-85	• • •	—	—
EXHIBIT 13			
	Tax Alternatives (\$Millions)		
	1983-85 Biennium*	1985-87 Biennium**	
Alternative			
Base Extensions			
1 Sales Tax on Motor Vehicle Fuel			
Including State & Federal Tax	—	\$ 375.0	
Excluding State & Federal Tax	—	295.0	
2 Sales Tax on Selected Services	\$ 32.2	772.3	
3 Eliminate B&O Exemption—			
Direct Sellers .....	.3	6.8	
4 Eliminate WHSL Functions			
(B&O) Exemption—Grocers .....	.2	4.8	
5 Extend Pub Util Tax to Garbage, Sewer	.4	10.2	
6 Eliminate Sales Tax Exemption—			
Res Local Phone Service .....	.9	23.8	
Tax Rate Increases			
1 B&O Surtaxes—Nonservice			
+25%9	22.4	
+50%	1.7	44.1	
+75%	2.6	66.6	
+100%	3.5	89.2	

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EXHIBIT 15

07/05/85

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2 Service Rate		
+.1	1.3	32.5
+.5	6.3	160.3
+1.0	12.8	324.7
3 Sales Tax		
+.1	2.5	67.0
+.3	7.5	200.7
+.5	12.3	333.6
+.7	17.2	466.0
+1.0	24.5	663.5
4 Real Estate Excise		
1.14% .....	.7	17.3
1.25%	1.8	44.5
1.50%	4.4	106.2
1.75%	7.0	168.0
2.00%	9.6	229.7
5 Conveyance Tax		
1.14% .....	.1	1.6
1.25% .....	.2	4.0
1.50% .....	.4	9.5
1.75% .....	.6	15.0
2.00% .....	.9	20.6
6 Insurance—Raise Domestic Rate to Equal Foreign	—	13.6
7 Estate Tax—Federal Ex. Levels, Rates 50% Higher	—	7.8
8 State Prop. Tax Levy— Raise 106% to 110%	—	28.7***
9 State Prop. Tax Levy— Raise From \$3.60 to \$4.00	—	139.2***
10 Cigarette Tax— Increase Rate 8 Cents	—	64.0
New Taxes		
Intangibles (1%)	—	20.0
1% Tax on Gross Income— Bus. & Indiv.	—	1,800.0***
Reinstate Inheritance Tax	—	88.5

*-Effective May 1, 1985

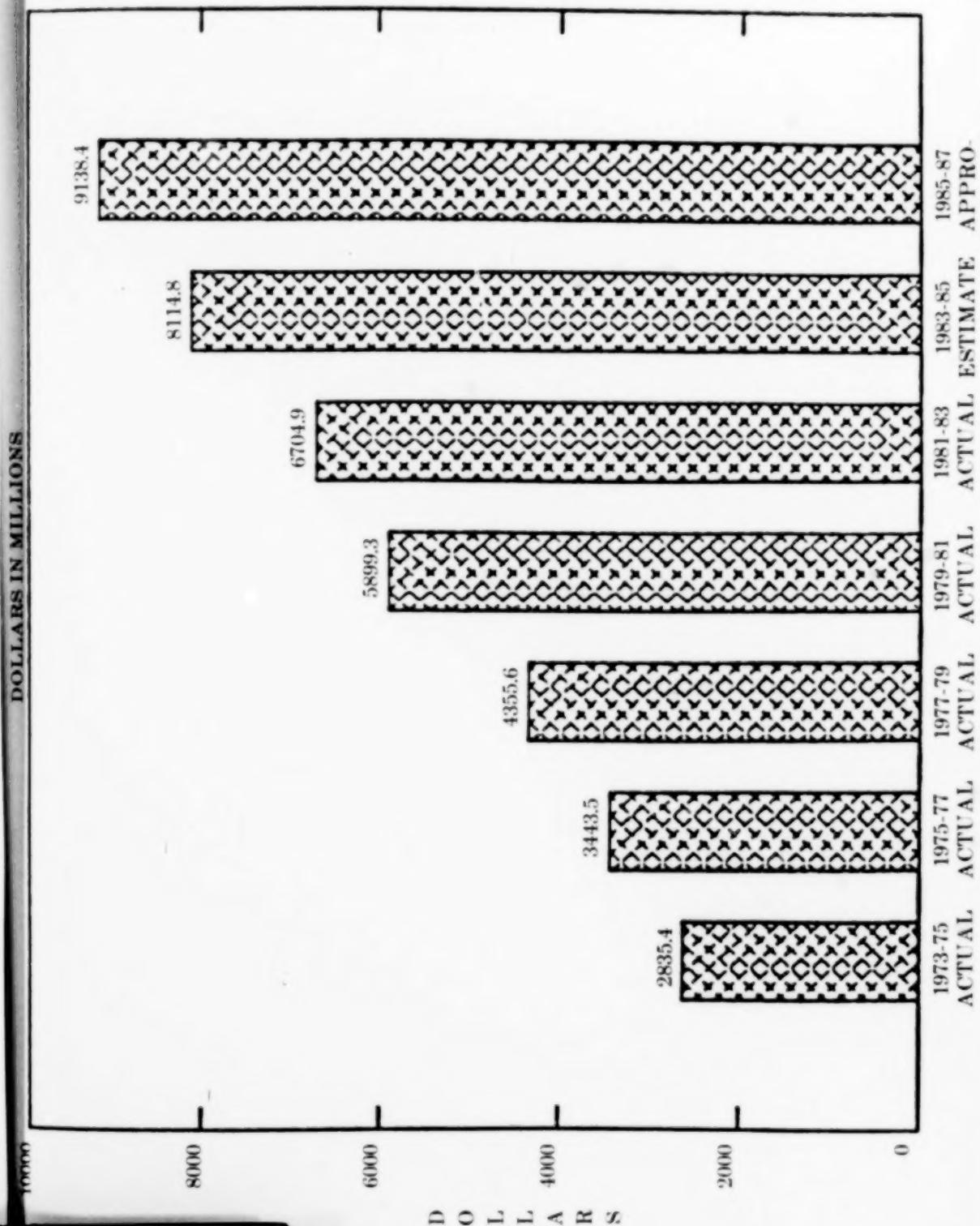
**-Effective June 1, 1985

***-18 Months

RESEARCH & INFORMATION DIVISION
DEPARTMENT OF REVENUE

03-APR-85

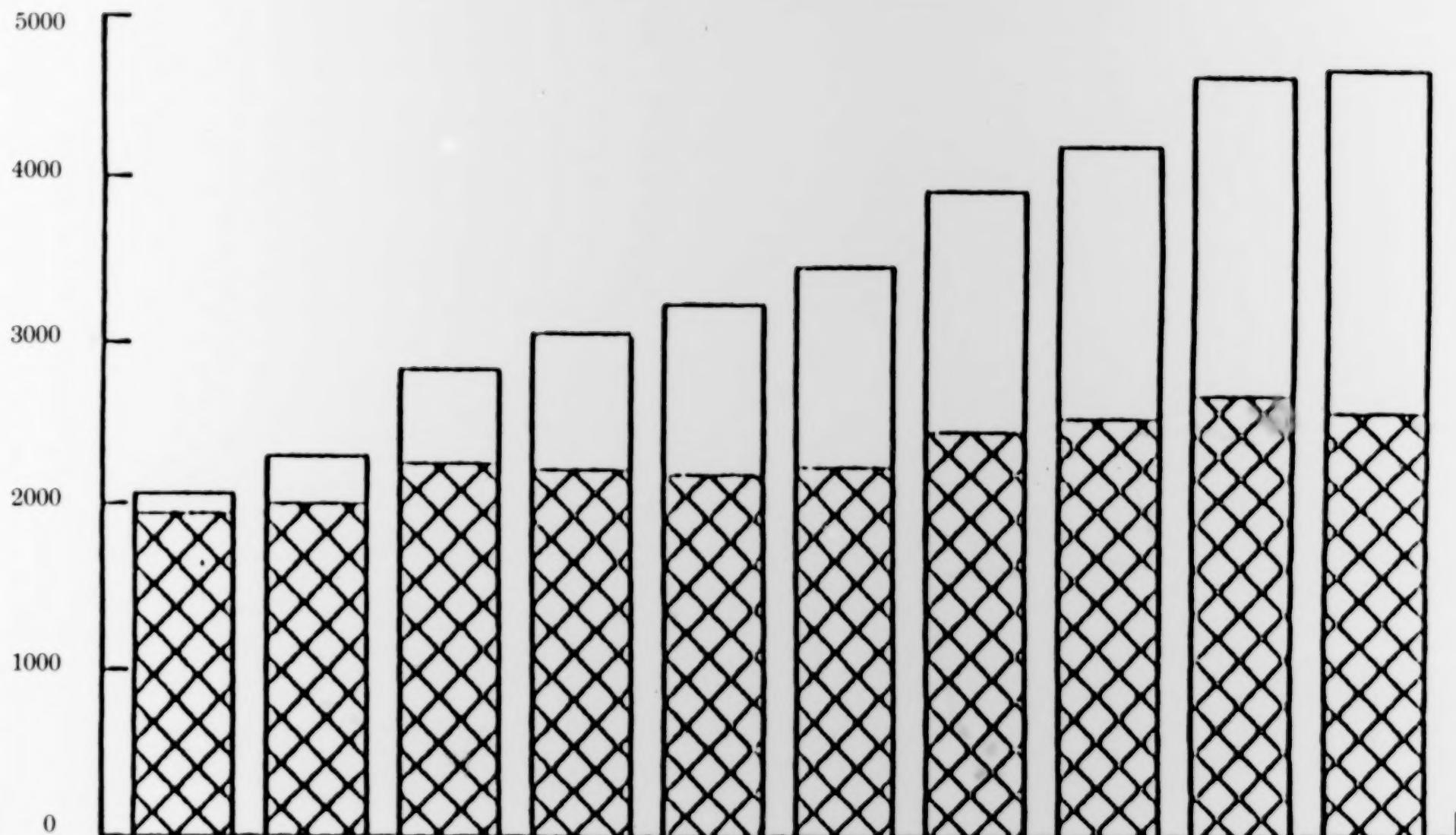
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**WASHINGTON STATE
LEAP BUDGETING REPORT
ANNUAL COMPARISON OF
TOT WASHINGTON STATE**

Date 04/01/85
Time 11:23

**GENERAL FUND-STATE
ACTUAL AND CONSTANT IPD(FY1977-BASE) DOLLARS IN MILLIONS**

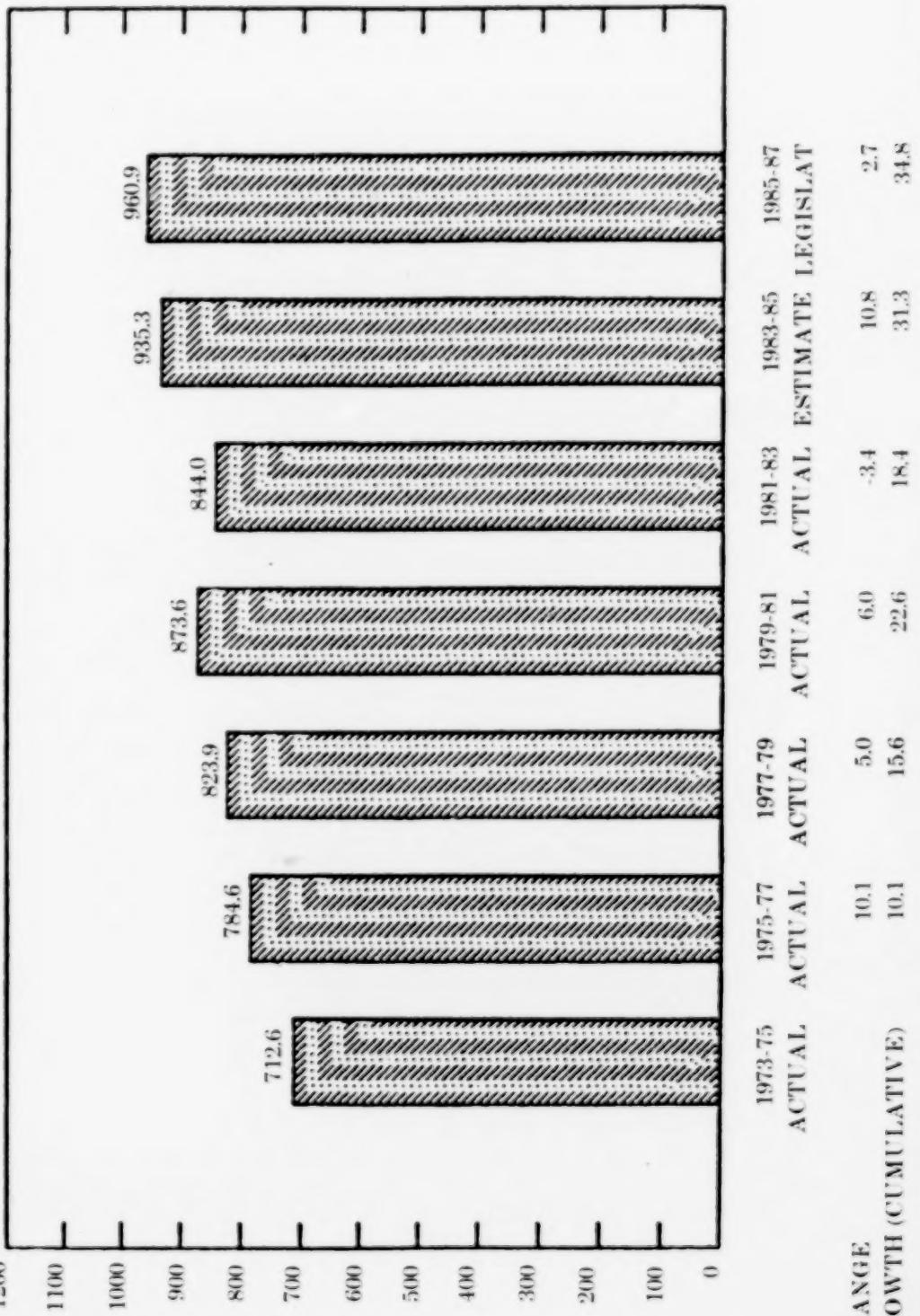


	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ESTIMATE	GARDNER	GARDNER
ACTUAL \$	2,060.2	2,295.4	2,837.4	3,061.8	3,239.7	3,465.2	3,928.6	4,206.5	4,637.9	4,686.1
CONSTANT \$	1,941.2	2,000.0	2,253.3	2,215.8	2,184.6	2,232.1	2,451.3	2,535.9	2,688.5	2,575.1

The difference between actual and constant dollars is solely inflation.
It does not depict population increases, court decisions, and older average age.

WASHINGTON STATE GENERAL FUND-STATE BIENNIAL EXPENDITURES
CONSTANT DOLLARS PER CAPITA 1973-75 THROUGH 1985-87

TIME 10:10



$\% \text{ CHANGE}$
 $\% \text{ GROWTH (CUMULATIVE)}$

	1973-75	1975-77	1977-79	1979-81	1981-83	1983-85	1985-87
ACTUAL	10.1	5.0	6.0	-3.4	10.8	2.7	
CUMULATIVE	10.1	15.6	22.6	18.4	31.3	34.8	

EXHIBIT 16

MAJOR TAX RATE AND BASE REDUCTIONS
SINCE 1970ESTIMATED STATE AND LOCAL IMPACT
FOR 1985-87 BIENNIIUM

(DOLLARS IN THOUSANDS)

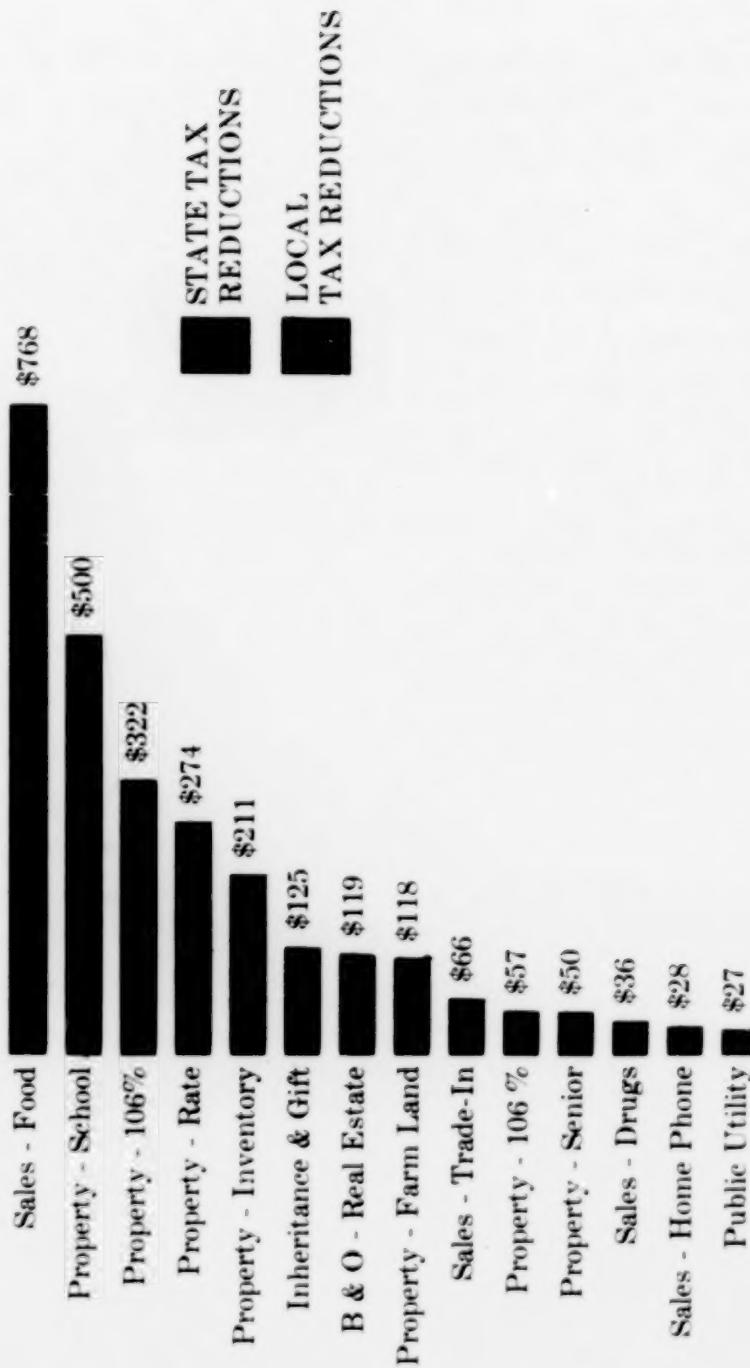
Tax Reduction (Year Effective)	State	Local	Total
Property Tax¹			
106 Percent Limit On Regular Levies:			
Local Levies (1974)	\$	\$ 322	\$ 322
State School Levy (1979)	57	....	57
10 Percent Reduction In Statutory Levy Rates (1975)	125	149	274
Limitation Of Special M&O School Levies (1977)	....	500	500 ²
Senior Citizens Exemption (1971, Last Expanded In 1983)	13	37	50
Current Use Assessment Of Farm Land (1973)	40	78	118
Exemption Of Business Inventories (1984-B&O Credit Since 1974)	67	144	211

¹ Because of the 106 percent limit, property tax exemptions do not always reduce taxing district revenues by the amount indicated; the impact is often shifted to remaining taxpayers.

² Special levies subject to voter approval. Based on historical success patterns, projected special levies would have been \$400 to \$600 million higher if the limitation were not imposed.

Tax Reduction (Year Effective)	State	Local	Total
Retail Sales Tax			
Exemption For Food Products Consumed Off-Premises (1978)			
	652	116	768
Exemption For Prescription Drugs (1974)	30	6	36
Exemption For Local Residential Telephone Service (1983)	24	4	28
Exemption For Trade-Ins Of Like-Kind Items (1984)	66	....	66
Other			
B&O Deduction For Real Estate Loans (1970)	119	....	119
Repeal Of Inheritance And Gift Taxes (1982)	125	....	125
Public Utility Deduction For Renewable Energy Resources (1980)	27	....	27
Total Biennial Savings To Taxpayers			
	\$1,345	\$1,356	\$2,701

MAJOR TAX RATE AND BASE REDUCTIONS SINCE 1970 — \$2,701 MILLION TOTAL
Estimated 1985-87 State and Local Impact



Figures in Millions of Dollars
Total State Reductions - \$1,345 Million
Total Local Reductions - \$1,356 Million

MAJOR TAX RATE AND BASE REDUCTIONS SINCE 1970
Estimated State and Local Impact for 1985-87 Biennium

Tax Reduction (Year Effective)	Amount (\$000,000)
Property Tax¹	
106% limit on regular levies:	
local levies (1974)	322
state school levy (1979)	57
10% reduction in statutory levy rates (1975)	274
Limitation of special M&O school levies (1977)	500 ²
Senior citizens exemption (1971, last expanded in 1983)...	50
Current use assessment of farm land (1973)	118
Exemption of business inventories (1984—B&O credit since 1974)	211
Retail Sales Tax	
Exemption for food products consumed off-premises (1978) ..	768
Exemption for prescription drugs (1974)	36
Exemption for local residential telephone service (1983) ...	28
Exemption for trade-ins of like-kind items (1984)	50
Other	
B&O deduction for real estate loans (1970)	119
Repeal of inheritance and gift taxes (1982)	125
Public utility deduction for renewable energy resources (1980)	27
TOTAL BIENNIAL SAVINGS TO TAXPAYERS	
	\$ 2,685

¹ Because of the 106% limit, property tax exemptions do not always reduce taxing district revenues by the amount indicated; the impact is often shifted to remaining taxpayers.

² Special levies subject to voter approval. Based on historical success patterns, projected special levies would have been \$400 to \$600 million higher if the limitation were not imposed.

Research & Information
Department of Revenue
May 20, 1985

* * *

EXHIBIT 18

PRELIMINARY OFFICIAL STATEMENT, DATED JULY 1, 1985

(This is a Preliminary Official Statement, subject to correction and change. This Preliminary Official Statement does not constitute an offer to sell nor the solicitation of an offer to buy in any jurisdiction in which it is unlawful to make such offer, solicitation or sale.)

In the opinion of Bond Counsel, interest on the Bonds is exempt from federal income taxes under existing federal law and rulings.

(SEAL)

\$230,440,000*
STATE OF WASHINGTON
GENERAL OBLIGATION BONDS

Dated: August 1, 1985

Due: September 1, as shown below

The Bonds are general obligations of the State to which the full faith, credit and taxing power of the State is unconditionally pledged. The Bonds maturing September 1, 1996 and thereafter are subject to redemption beginning September 1, 1995 at par, plus accrued interest to the date of redemption.

The Bonds of each series are issuable in fully registered form in the denomination of \$5,000 or any integral multiple thereof.

Interest on the Bonds is payable on March 1, 1986 (seven months) and semiannually thereafter on each September 1 and March 1.

Amounts of Maturities

Year	Amount of Maturities Due			Amount of Maturities or Mandatory Redemption Due		
	September 1	Rate	Yield or Price	Year	September 1	Rate
1986	\$ 5,590,000	%	%	1999	\$14,965,000	%
1987	6,830,000			2000	16,055,000	
1988	7,225,000			2001	17,250,000	
1989	7,645,000			2002	4,420,000**	
1990	8,145,000			2003	4,835,000**	
1991	8,660,000			2004	5,270,000**	
1992	9,255,000			2005	5,760,000**	
1993	9,895,000			2006	6,270,000**	
1994	10,570,000			2007	6,860,000**	
1995	11,310,000			2008	7,485,000**	
1996	12,125,000			2009	8,165,000**	
1997	13,005,000			2010	8,915,000**	
1998	13,935,000					

(Plus accrued interest)

*Subject to change.

**Subject to optional bidder designation of Term Bonds, in which case the amounts shown may be retired by mandatory redemption. See Official Notice of Sale and Description of the Bonds herein.

The Bonds are offered when, as and if issued, subject to approval of legality by Messrs. Bogle & Gates, Seattle, Washington, Messrs. Perkins Coie, Seattle, Washington, Messrs. Preston, Thorgrimson, Ellis & Holman, Seattle, Washington, Messrs. Riddell, Williams, Bullitt & Walkinshaw, Seattle, Washington or Messrs. Roberts & Shefelman, Seattle, Washington, Bond Counsel, and certain other conditions.

July , 1985

* * *

Washington's 1984 unemployment rate of 9.5% exceeded the U.S. rate of 7.5%. However, because of the industrial mix of the economy, the State's unemployment rate has generally been higher than the national rate. The State's April 1985 seasonally adjusted unemployment rate was 8.8%.

Budgetary Controls

The State operates on a July 1 to June 30 fiscal year and on a biennial budget basis, the constitutionally prescribed fiscal period. The current biennium will end June 30, 1985. State law requires a balanced biennial budget. Furthermore, whenever it appears that expenditure of appropriated funds will exceed revenues, the Governor is required to reduce expenditures of appropriated funds. To assist in its financial planning, the State prepares quarterly econometric forecasts which are derived from national econometric models. The legislature, through enactment of ESHB No. 1083 in 1984, established the Economic and Revenue Forecasting Council in the Department of Revenue. This Council consists of six members, two appointed by the Governor, and two appointed from each of the political caucuses of the Senate and House of Representatives. The Council approves the official revenue forecast for the State of Washington.

Revenues and Expenditures

State taxes include excise taxes and ad valorem property taxes; the State Constitution, as interpreted by the State Supreme Court, prohibits the imposition of net income taxes. The principal excise taxes which support the State's General Fund are the retail sales tax and the business and occupation tax. Excise taxes on motor fuels

are dedicated to supporting highway and road construction and maintenance. The level of revenues generated by both the retail sales tax and the business and occupation tax is very sensitive to changes in disposition of personal income making it difficult accurately to forecast revenue receipts. From 1976 to 1979 those tax revenues increased substantially faster than personal income. From 1980 to 1982, growth in those tax revenues significantly lagged increases in income, resulting in the necessity for reduced expenditures, increased taxes, and deferred retirement fund payments in the 1981-83 biennium. The increase in fiscal 1983 exceeded the growth in personal income due in part to legislative enacted tax rate increases and a temporary extension of the sales tax base to include food for home consumption. Due to a stronger State economy in Fiscal Year 1984, retail sales and business and occupation tax revenues increased more rapidly than personal income. Growth in the retail sales tax and the business and occupation tax is projected to lag personal income growth in Fiscal Years 1986 and 1987, after adjustments have been made to offset the affect of the elimination of the "twenty-fifth month" in the 1983-85 biennium.

1983-85 Biennium

The 1983-85 Biennium ended June 30, 1985. The most recent revenue and economic forecast approved by the Revenue and Economic Forecast Council in June 1985 estimates total General Fund revenues at \$9,976.5 million including private-local and federal funds. Subsequent to the June 1985 forecast, changes in federal and private-local reimbursement increased revenues by \$37.3 million,

to a biennial total of \$10,013.8 million. The official revenue forecast for the general fund-state portion was \$8,107.2 million. After legislative changes, however, the General Fund-State estimate is \$8,109.2 million. Combined retail sales and business and occupation revenues are approximately 36.7 percent and 12.4 percent, respectively, of the total General Fund.

Total General Fund expenditures are estimated at \$10,019.3 million. Approximately 51.6% of this amount is for education and 37.1% for human resources.

1985-87 Biennium

The 1985-87 budget passed in June 1985 was based on the June economic and revenue forecast approved by the Economic and Revenue Council. After revisions resulting from legislative action and revised collection procedures, current revenue estimates are \$9,314.9 for General Fund-State, and \$11,442.1 for the total General Fund, including the federal and private-local portion, representing increases of 14.9 percent and 14.3 percent, respectively.

Of total general fund expenditures of \$11,267.0 million, approximately 52.8 percent is for education and 37.3 percent for human resources. The anticipated ending fund balance is \$175.1 million.

The 1985-87 Capital budget funds the first two fiscal years (FY 1986 and 1987) of the State's "Six Year Facility and Capital Plan." The budget contains \$588 million from all funds to support more than 350 projects in all areas of state government. Education programs will receive \$420 million or 71.4 percent of all capital funds and human resources will receive \$75 million or 12.7 percent.

• • •

Litigation Potentially Affecting Future Expenditures and Revenues

The United States Federal District Court for Western Washington has recently held in a "comparable worth" lawsuit that the State of Washington had discriminated and continues to discriminate against women employees of the State in violation of Title VII of the Federal Civil Rights Act. The State has appealed the court's decision.

The Office of Financial Management estimates that the financial impact on the State of the legal position originally proposed by the plaintiffs would have been in excess of \$900 million. In a January 10, 1984 ruling the district court denied some of the plaintiffs' requests for damages (including interest on back pay of approximately \$125 million) and granted others. A preliminary estimate by the Office of Financial Management of the financial impact on the State if the ruling were affirmed on appeal is approximately \$377 million, of which approximately \$95 million would be current salary costs for the 1983-85 biennium. The balance would be back pay and associated pension funding requirements. Both the State and the plaintiffs have appealed the district court decision. On March 5, 1984, the State was granted a stay of payments on the decision by the U.S. Ninth Circuit Court of Appeals, pending outcome of appeal. The State estimates that approximately 66% of any payments which may be due as a result of such litigation would be payable from the General Fund and the balance from other State funds.

The budget for the 1985-87 biennium appropriates \$45.9 million for implementation of comparable worth salary increases. The expenditure of \$41.4 million out of

this appropriation, however, is contingent upon settlement of the litigation.

In addition, in December 1984, tax refund suits were brought against the State of Washington by more than 170 manufacturers and out-of-state manufacturers selling products in Washington, alleging the unconstitutionality of Washington's manufacturing, wholesaling, and retailing business and occupation tax as applied to these businesses. The refund claims are based upon the recent ruling of the United States Supreme Court in *Armco, Inc. v. Hardesty*, — U.S. —, 81 L.Ed.2d 540 (1984), holding that West Virginia's wholesaling business and occupation tax discriminated against out-of-state manufacturers selling in that state.

Claims in litigation and administrative requests for refund filed with the Washington State Department of Revenue currently approximate \$96 million for the period 1980-84. The State anticipates additional refund claims in 1985 with respect to tax years 1981-84, not foreclosed by the statute of limitations.

On June 24, 1985, the Thurston County Superior Court denied the claims for refund and upheld application of the tax. Because of the nature of the issues in the litigation an appeal to the Washington State Supreme Court, and thereafter to the United States Supreme Court, is probable.

If damages ultimately are assessed against the State as a result of the "comparable worth" lawsuit or refunds are ordered in the tax litigation, the State could, among other things, reduce expenditures on services, reduce the number of its employees, restrict the number of new em-

ployees hired, defer employee salary increases, increase user fees and license taxes, use any existing general fund surplus or raise certain taxes. Tax refunds would be payable from the General Fund.

For a further discussion of these lawsuits, see "Litigation" herein.

* * *

LITIGATION

There is not now pending any litigation restraining or enjoining the sale, issuance, execution or delivery of the bonds or in any other manner affecting the validity of the bonds or the proceedings or authority pursuant to which they are to be sold and issued.

At any given time, including the present, there are numerous lawsuits pending against the State of Washington which would, if successful, affect the state's revenues or expenditures. The Attorney General of the state is of the opinion, however, that with certain exceptions below noted, no pending suits within that category would, if successful, have a material adverse effect on either state revenues or expenditures:

(1) "Comparable Worth" Litigation:

The first exception involves a "Comparable Worth" suit brought by the Washington Federation of State Employees in the United States District Court. The lawsuit, which is the first such lawsuit brought against any state, claims that the State of Washington pays less to employees in certain job categories held predominantly by women than to those employees in different job categories held predominantly by men and regarded as comparable.

On December 14, 1983, the district court entered its decision finding that the State of Washington was thus discriminating. Based on that finding the court awarded the plaintiffs both prospective relief and back pay, but denied their request for prejudgment interest in the approximate amount of \$125 million. The estimated cost of the award, if sustained on appeal, would be approximately \$375 million—compared to the approximately \$960 million which the plaintiff union initially sought.

Both the state and the union then appealed the decision of the district court to the Ninth Circuit Court of Appeals. On March 5, 1984, the appellate court accepted jurisdiction of the case as appealed, and it further granted the state's request for a stay of the district court's decision. Accordingly, the state is not now required to change its compensation system or to pay any monies as ordered by the district court pending appeal. The case was orally argued before the Court of Appeals on April 4, 1985 and is now under advisement. Considering the novelty of the lawsuit, the state believes that it will be ultimately appealed to the United States Supreme Court by whichever party is unsuccessful before the Ninth Circuit Court of Appeals.

(2) *Business and Occupation Tax—Interstate Commerce Challenge:*

During the last week of December, 1984, suits were commenced in the Thurston County (Washington) Superior Court by a large number of Washington manufacturing firms as well as several out-of-state manufacturers selling their products in Washington. Those suits challenged the constitutionality of Washington's business and

occupation tax as applied to (a) Washington manufacturers who sell their products elsewhere and (b) out-of-state manufacturers who sell their products in Washington. The cases are based upon the Commerce Clause of the United States Constitution as recently construed and applied by the United States Supreme Court in the *Armco* case (*Armco v. Hardesty*, — U.S. —, 81 L.Ed.2d 540 (1984)) out of West Virginia. The plaintiffs, at this time, are seeking a refund of business and occupation taxes paid since 1980. According to the most recent Department of Revenue estimates the total potential recovery by the plaintiffs, and others similarly situated should they also elect to sue, would be in the neighborhood of \$248 million with respect to the tax on manufacturing and approximately \$176 million should the tax on out-of-state manufacturers selling their products in Washington also be invalidated. The principal cases were consolidated for argument before the Thurston County Superior Court. On June 24, 1985, that court issued a memorandum opinion denying the refunds and upholding both applications of the tax. This matter, likewise, is one which will quite probably involve, ultimately, an appeal to the United States Supreme Court for final resolution. It should also be noted, however, that a bill was enacted by the recently adjourned state legislature which is designed to reduce the potential level of state liability in this area. See "1985 Legislative Changes."

(3) *WPPSS Bondholders Suit:*

In late November of 1984 holders of Washington Public Power Supply System (WPPSS) Project No. 4 and No. 5 revenue bonds sued the State of Washington and certain elected officials of the state in a class action in

King County (Washington) Superior Court seeking, under several alternative theories, to impose liability on the state as a consequence of default by WPPSS on those bonds. The position of the state in response to this action is that neither it nor any of its officers are liable on the bonds or as a consequence of the default. The Superior Court agreed and, on June 27, 1985, granted the state's motion to dismiss the action for failure to state a legally viable claim. The total amount sought by the plaintiffs by way of damages is in excess of \$7.25 billion and an appeal is currently under consideration.

* * *

EXHIBIT 19

**PROPOSED REVISIONS
TO THE
1985-87 OPERATING BUDGET**

(SEAL)

Submitted by
Governor Booth Gardner

March 1985

WASHINGTON STATE REVENUE
(Dollars in Thousands)

Source	1983-85 Biennium		1985-87 Biennium	
	General Fund	All Funds	General Fund	All Funds
State Taxes				
General and Selective Sales				
Retail Sales	3,721,051	3,809,706	4,417,756	4,547,965
Use	327,423	327,423	391,398	391,398
Motor Vehicle Fuels	0	734,316	0	849,924
Liquor Sales	143,708	160,612	152,342	170,304
Cigarette and Tobacco	197,079	197,079	207,419	207,419
Real Estate Excise	189,270	189,270	262,375	262,375
Gross Receipts				
Business and Occupation ...	1,269,401	1,269,401	1,598,202	1,598,202
Public Utility	238,873	238,873	275,285	275,285
Insurance Premiums	113,660	113,660	128,608	128,608
Property & In-Lieu Excises				
Property	978,573	978,573	1,139,317	1,139,317
Motor Vehicle Excise	375,681	423,489	425,597	473,916
Boat Excise	8,454	8,454	15,441	15,441
Public Utility District Excise .	33,740	33,740	40,090	40,090
Timber Excise	32,980	75,645	37,380	78,170
Miscellaneous				
Inheritance and Gift	38,826	38,826	22,600	22,600
Other Taxes	102,525	116,892	114,179	130,856
Total Taxes	7,771,244	8,715,959	9,227,989	10,331,870
State Non-Tax Revenue				
Licenses, Permits, Fees	61,967	441,629	68,065	467,661
Liquor Profits and Misc Revenue	54,858	102,358	50,237	94,185
Earnings on Investments	56,700	167,137	51,900	159,811
Tuition	228,664	266,558	250,789	298,582
Timber Sales	2,556	173,415	2,870	147,390
Lottery	134,746	185,072	196,795	266,920
Proceeds of Bond Issues ...	0	786,525	0	1,068,439
Debt Service	—204,433	6,759	—264,213	12,463
Other Non-Tax Revenue	44,176	1,219,975	40,364	1,648,827
Total Non-Tax Revenue ...	379,234	3,349,428	396,807	4,164,278
Total State Revenue	8,150,478	12,065,387	9,624,796	14,496,148
Federal Revenue	1,881,032	3,051,874	2,090,184	3,443,131
Private/Local Revenue	25,130	112,130	28,529	129,213
TOTAL	10,056,640	15,229,391	11,743,509	18,068,492

Table 15
BUDGETED TREASURY FUNDS—CASH SURPLUS

GENERAL FUND		GENERAL FUND		GENERAL FUND	
General Fund		General Fund		General Fund	
By Fund Classification, Fund		6/30/83	6/30/85	1985-87	1985-87
		Actual	Estimated	Proposed	Proposed
		Balance	Balance	Revenue	Expenditures
Aeronautics Account	448,805	213,280	—	1,367,047	1,381,955
Aquatic Lands Enhancement Account	—	544,546	1,555,690	2,099,700	198,372
Architects License Account	177,966	256,071	375,600	470,210	536
Archives & Records					161,461
Management Account	6,661	45,310	1,715,873	1,756,911	4,272
Business Enterprises Revolving Account	—	190,110	692,002	666,439	215,673
C E P and R I Account	2,488,488	1,472,353	(66,150)	930,000	476,203
Capitol Building Construction Account	1,670,576	1,397,454	3,935,298	5,270,000	62,752
Capitol Purchase and Development Account	709,290	880,934	1,661,699	928,000	1,614,633
Cemetery Account	8,317	480	130,731	117,870	13,341
Centennial Commission Account	—	—	251,069	188,302	62,767
Central Washington University Capital Projects Account	2,753,341	3,232,522	4,126,861	3,957,000	3,402,383
Certified Public Account	—	33,590	404,990	410,148	28,432

	6/30/83 Actual Balance	6/30/85 Estimated Balance	1985-87 Proposed Revenue	1985-87 Proposed Expenditures	6/30/87 Estimated Balance
Community College Capital Construction Account	1,559,386	253,875	—	253,000	875
Community Colleges Capital Projects	3,224,827	—	331,267	1,000	330,267
Convention and Trade Center Account	90,972,307	75,905,018	8,931,794	80,437,592	4,399,220
County Sales and Use Tax Account	(10,051)	915	7,894,000	7,894,000	915
Crime Victims Compensation Account	827,921	250,673	—	—	250,673
Criminal Justice Training Account	1,617,352	14,880	—	—	14,880
Death Investigations Account	—	458,327	1,065,562	933,694	590,195
DHS Construction Account	6,717,828	14,768,131	78,616,000	93,174,000	210,131
Eastern Washington University Capital Projects Account	928,302	1,005,786	2,770,111	3,045,000	730,897
Feed and Fertilizer Account	12,197	12,208	17,600	17,306	12,502
Fire Training Construction Account	4,368,784	1,152,143	393,484	1,219,000	326,627
Fisheries Capital Projects Account	1,135,473	2,328,782	3,261,000	4,367,000	1,222,782
Flood Control Assistance Account	—	—	4,000,000	4,000,000	—
Forest Development Account	4,086,496	9,918,506	10,614,461	20,409,370	123,597
Geothermal Account	—	5,156	291,400	219,534	77,022
Handicapped Facilities Construction Account	1,933,236	4,242,406	—	4,242,000	406
Harbor Improvement Account	133,562	95,589	22,080	22,073	95,596
Hazardous Waste Control & Elimination Account	—	165,124	2,304,000	2,423,012	46,112
Health Professions Account	(7,758)	753,989	5,530,040	6,012,521	271,508
Higher Education Construction Account-1979	(2,494,123)	7,609,834	35,440,000	39,740,000	3,309,834
Higher Education Reimbursable Short Term Bond Account	—	—	22,954,000	22,954,000	—

Hospital Commission Account	155,151	141,323	1,346,604	1,336,588	151,339
Institutional Impact Account	(16,695)	48,435	350,000	375,000	23,435
Judiciary Education Account	1,065,237	—	—	—	—
Landowners Contingency Forest Fire Suppression	943,278	1,472,900	1,440,383	1,505,161	1,408,122
Litter Control Account	1,351,718	1,582,491	5,135,000	4,773,888	1,943,603
Local Improvement Revolving Account-Water Supply Facilities	353,355	10,432,004	81,016,968	87,997,487	3,451,485
Local Improvements Revolving Account-DSHS Facilities	1,633,605	1,783,395	253,286	1,290,000	746,681
Local Improvements Revolving Account-Waste Disposal	4,325,738	5,631,707	42,092,928	47,111,594	613,041
Local Jail Improvement and Construction Account	(511,827)	23,123,807	10,121,885	33,140,470	105,222
LIR Account-Public Recreation Facilities LIR Account-Waste Disposal Facilities 1980	977,644	444,790	143,660	376,000	212,450
Marine Fuel Tax Refund	15,859,508	48,253,068	229,775,083	277,137,437	890,714
Medical Disciplinary Account	97,215	88,105	—	—	88,105
Millersylvania Park Current Account	—	458,301	716,200	876,981	297,520
Motor Transport Account	2,258,727	2,244,439	6,907,808	6,829,073	7,288
Municipal Sales and Use Tax Account	—	1,093	23,485,210	23,485,000	2,323,174
Opticians Account	98,629	101,759	—	—	1,303
Optometry Account	52,734	55,389	—	—	55,389
Outdoor Recreation Account	1,651,042	7,150,158	24,172,584	30,649,085	673,657
ORV (Off Road Vehicle) Account	1,805,236	2,583,885	3,672,246	4,915,811	1,340,320

	6/30/83 Actual Balance	6/30/85 Estimated Balance	1985-87 Proposed Revenue	1985-87 Proposed Expenditures	6/30/87 Estimated Balance
Pilotage Account	13,946	918	79,500	79,948	470
Professional Engineers Account	391,333	391,489	646,060	805,688	231,861
Public Facilities Construction					
Loan and Grant Revolving	4,316,454	4,291,000	55,308	—	4,346,308
Public Safety and Education Account	3,942,719	2,758,672	49,869,380	49,022,752	846,628
Real Estate Commission Account	1,195,006	713,559	3,438,310	5,290,057	906,925
Reclamation Revolving Account	193,297	8,807,180	425,155	1,124,439	14,275
Resource Management Cost Account	71,628,417	28,417	47,959,438	52,260,021	4,506,597
Revenue Accrual Account			—	—	28,417
Salmon Enhancement					
Construction Account	3,521,393	1,523,351	1,000,000	2,500,000	23,351
Sanitarian's Licensing Account	9,997	10,022	—	—	10,022
Search and Rescue Account	38,575	40,408	110,000	110,981	39,427
Snowmobile Account	315,472	157,054	579,564	655,462	81,156
Special Grass Seed Burning					
Research Account	36,671	—	69,182	69,182	—
State Board of Psychological Examiners Account	32,394	34,549	—	—	34,549
State Building Construction Account	(352,578)	6,639,639	61,152,000	67,699,000	92,639
State Capitol Historical Association Museum Account	74,786	75,479	107,000	122,556	59,923
State Capitol Vehicle Parking Account	206,537	46,938	102	—	47,040
ACCOUNTS WITHIN THE GENERAL FUND					
State Educational Grant Account	15,410	47,495	85,000	40,000	92,495
State Emergency Water Projects Revolving Account	11,555,313	7,024,023	513,181	7,350,655	186,549

State Facilities Renewal Account	—	—	58,303,000	58,303,000	—
State Higher Education Construction Account	256,806	4,922,122	94,276,000	96,958,000	2,240,122
State Investment Board Expense Account	10,018	10,062	1,555,261	1,556,173	9,150
State Timber Tax Account A	956,822	462,349	317,499	—	779,848
State Timber Tax Reserve Account	2,928,342	33,421	459,774	—	493,195
Survey and Maps Account	259,425	252,915	686,944	732,087	207,772
The Evergreen State College Capital Projects Account	109,070	40,160	220,015	132,000	128,175
Timber Tax Distribution Timber Tax Distribution	—	10,000	41,490,000	40,718,159	781,841
Guarantee Account	10,463,390	1,546,527	—	—	1,546,527
Traffic Safety Education Account	2,334,857	—	—	—	—
Trust Land Purchase Account	2,457,319	1,946,612	7,567,947	7,665,083	1,849,476
University of Washington Building Account	344,230	1,178,955	4,590,035	5,534,000	234,990
Washington State University Construction Account	175,332	56,564	25,626	—	82,190
Water Quality Bond Account	3,570,987	5,730,530	14,779,425	17,223,000	3,286,955
Western Washington University Capital Projects Account	12,702	12,702	100,000,000	100,000,000	12,702
Winter Recreation Program Account	442,005	840,428	3,867,063	4,011,000	696,491
TOTAL Accounts within the General Fund	101,690	117,319	194,828	310,000	2,147
	<u>276,934,903</u>	<u>282,563,188</u>	<u>1,125,639,951</u>	<u>1,351,613,455</u>	<u>56,589,684</u>

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	6/30/83 Actual Balance	6/30/85 Estimated Balance	1985-87 Proposed Revenue	1985-87 Proposed Expenditures	6/30/87 Estimated Balance
SPECIAL REVENUE—MOTOR VEHICLE					
Motor Vehicle Fund	37,533,518	10,489,848	1,590,197,221	1,596,735,095	3,951,974
SPECIAL REVENUE—ALL OTHER					
Administrative Contingency Fund	1,328,892	1,310,734	5,892,521	5,844,502	1,358,753
Commercial Feed Fund	168,052	228,599	506,656	482,739	252,516
Common School Construction Fund	6,008,410	28,309,975	130,757,963	156,013,000	3,054,938
Electrical License Fund	1,241,345	2,754,537	9,014,866	7,323,588	4,445,815
Fertilizer, Agricultural, Mineral and Lime Fund	135,293	202,888	452,960	435,812	220,036
Forest Reserve Fund	—	—	25,164,000	25,164,000	—
Game Special Wildlife Account	4,444	3,393	304,056	296,561	10,888
Grade Crossing Protective Fund	1,580,450	1,348,346	287,915	200,000	1,436,261
Highway Safety Fund	8,832,104	2,028,200	50,993,652	51,114,115	1,907,737
Hood Canal Bridge Account	5,546,163	101,296	186,007	—	287,303
Liquor Excise Tax Fund	2,813,620	2,671,083	17,962,400	17,962,400	2,671,083
Motorcycle Safety Education Account	35,720	49,908	145,474	192,645	2,737
Nursery Inspection Fund	271,172	426,995	725,558	631,396	521,157
Public Service Revolving Fund	3,848,949	4,500,603	17,742,121	20,684,692	1,558,032
Puget Sound Capital Construction Account	8,687,509	4,191,892	47,178,726	42,928,101	8,442,517
Puget Sound Ferry Operations Account	—	214,983	48,024,086	47,371,084	867,985
Puget Sound Reserve Account	173,411	353,369	4,148,213	3,958,145	543,437
Recreational Vehicle Account	58,147	478,113	417,759	—	895,872

Rural Arterial Trust Account	—	4,891,039	17,744,755	21,042,261	1,593,533
Seed Fund	131,040	108,063	1,028,170	984,589	151,644
State Game Fund	8,580,893	5,071,475	66,878,372	68,858,136	3,091,711
State Patrol Highway Account	365,157	12,552,648	121,849,117	127,029,439	7,372,326
Stream Gaging Basic Data Fund	47,108	24,608	211,774	200,000	36,382
Unemployment Compensation Administration Fund	725,413	2,762,475	110,162,705	104,596,786	8,328,394
Urban Arterial Trust Account	9,921,037	12,150,326	69,827,305	68,485,543	13,492,088
Vessel Gear License and Permit Reduction Fund	(122,864)	216,077	—	—	216,077
Voluntary Action Center Account	—	654	—	—	654
TOTAL Special Revenue - All Other .	60,381,465	86,952,279	747,607,131	771,799,534	62,759,876
BOND RETIREMENT AND INTEREST					
Common School Building Bond Redemption Fund-1967	1,942,962	127,849	6,971,488	6,876,110	223,227
Community College Capital Construction Bond Retirement	472,033	637,867	16,487,149	16,067,247	1,057,769
Community College Capital Im- provement Bond Redemption Fund ..	367,867	485,124	7,426,240	7,508,345	403,019
Community College Refunding Bond Retirement Fund-1974	535,822	815,817	9,403,137	9,457,123	761,831
Emergency Water Projects Bond Redemption Fund-1977	20,367	26,832	2,612,282	2,594,770	44,344
Ferry Bond Retirement Fund 1979	4,319,992	6,722,046	29,640,319	29,142,170	7,221,095
Fisheries Bonds 1977 Bond Redemption Fund	14,346	15,811	3,466,799	3,476,774	5,836

	6/30/83 Actual Balance	6/30/85 Estimated Balance	1985-87 Proposed Revenue	1985-87 Proposed Expenditures	6/30/87 Estimated Balance
General Administration Bond Redemption Fund	23,627	360,316	665,934	29,425	996,825
General Obligation Bond Retirement 1979	895,509	42,016	208,999,872	208,589,280	452,608
Higher Education Bond Retirement Fund of 1977	35,400	66,549	15,063,799	15,087,751	42,597
Higher Education Bond Retirement-1979	93,926	98,481	32,487,498	32,531,592	54,387
Higher Education Refunding Bond Retirement Fund of 1977	73,882	95,777	8,808,897	8,746,565	158,109
Highway Bond Retirement Fund	16,966,098	25,371,050	150,777,946	138,861,113	37,287,883
Indian Cultural Center Construction Bond Redemption Fund	531	9,197	243,406	234,600	18,003
Juvenile Correctional Institutional Bldg Bond Redemption	334,893	—	—	—	—
Loan Principal and Interest Fund	—	—	—	—	—
Office-Laboratory Facilities Bond Redemption Fund	16,127	21,492	290,879	276,830	35,541
BOND RETIREMENT AND INTEREST					
Outdoor Recreation Bond Redemption Fund-1967	3,269,858	3,414,879	6,569,332	6,276,470	3,307,741
Public School Building Bond Redemption Fund-1961	341,428	341,428	—	—	341,428
Public School Building Bond Redemption Fund-1963	4,627,702	—	—	—	—

BOND RETIREMENT AND INTEREST

Outdoor Recreation Bond Redemption Fund-1967	3,269,858	3,414,879	6,569,332	6,276,470	3,307,741
Public School Building Bond Redemption Fund-1961	341,428	341,428	—	—	341,428
Public School Building Bond Redemption Fund-1963	4,627,702	—	—	—	—

Public School Building Bond Redemption Fund-1965	107,893	145,901	2,458,323	2,470,955	133,269
Recreation Improvements Bond Redemption Fund	333,689	442,925	5,881,072	5,990,090	333,907
Salmon Enhancement Construction Bond Retirement Fund	33,206	45,016	4,661,918	4,666,130	40,804
Social and Health Services Bond Redemption Fund of 1976	316,936	419,969	9,556,904	9,480,564	496,309
Social and Health Services Facilities Bond Redemption Fund	176,821	233,300	3,687,473	3,734,611	186,162
Spokane River Toll Bridge Account ... State Building and Higher Ed Bond Redemption Fund-1965	261,143	203,265	915,884	886,400	232,749
State Building and Higher Ed Bond Redemption Fund-1967	141,739	190,583	3,141,318	3,215,565	116,336
State Building and Parking Bond Redemption Fund-1969	297,894	389,480	9,994,822	10,240,447	143,855
State Building Authority Bond Redemption Fund	555,314	740,894	9,349,879	9,562,105	528,668
State Building Bond Redemption Fund-1975	37,571	71,987	1,406,327	1,358,440	119,874
State Building Bond Redemption Fund-1967	715,674	766,214	762,814	652,100	876,928
State Building Bond Redemption Fund-1973	150,380	198,613	3,755,136	3,824,535	129,214
State Building Bond Redemption Fund-1973A	12,611	16,294	385,957	375,371	26,880
State Building Construction Bond Redemption Fund	193,926	193,926	—	—	193,926

	<i>6/30/83 Actual Balance</i>	<i>6/30/85 Estimated Balance</i>	<i>1985-87 Proposed Revenue</i>	<i>1985-87 Proposed Expenditures</i>	<i>6/30/87 Estimated Balance</i>
State Facilities Renewal					
Bond Retirement Fund	—	—	6,465,000	6,356,000	109,000
State Higher Education Bond Redemption Fund-1973	198,220	261,338	4,346,042	4,374,678	232,702
State Higher Education Bond Redemption Fund-1974	40,548	54,313	1,237,017	1,201,300	90,030
University of Washington Bond Retirement Fund	(24,092)	2,046,313	227,522	—	2,273,835
Washington State University Bond Retirement Fund	4,551	6,261	563,450	559,295	10,416
Washington State University Bond Retirement Fund	2,966,422	2,617,709	(904,388)	—	1,713,321
Waste Disposal Facilities	1,184,681	160,646	99,035,872	98,604,041	592,477
Bond Redemption Fund	108,451	144,356	3,946,940 50,000	4,015,067 —	76,229 50,000
Water Pollution Control Facilities	532,874	766,638	11,797,062	11,974,758	588,942
Bond Redemption Fund	100,718	131,598	2,159,144	2,173,165	117,577
1975 State Higher Education Bond Retirement Fund	59,036	78,984	1,157,759	1,165,915	70,828
1975 University of Washington Hospital Bond Retirement Fund	37,731	49,500	798,589	766,136	81,953
1976 Fisheries Bond Retirement Fund					

	<i>1977 Fire Service Training Center Bond Retirement Fund</i>	<i>4,979</i>	<i>15,530</i>	<i>1,617,821</i>	<i>1,626,243</i>	<i>7,108</i>
	<i>TOTAL Bond Retirement and Interest</i>	<i>45,571,522</i>	<i>51,894,735</i>	<i>690,649,049</i>	<i>677,486,956</i>	<i>65,056,828</i>
WORKING CAPITAL						
Administrative Hearings Revolving Fund	74,882	136,954	8,280,362	8,404,131	13,185	
Auditing Services Revolving Fund	171,625	251,681	7,887,948	7,832,163	307,466	
Centennial Partnership Fund	61,471	—	—	—	—	
Coastal Protective Revolving Fund	8,077,426	7,799,460	86,847,202	42,926	28,961	
Data Processing Revolving Fund	572,607	1,243,043	14,387,790	87,724,909	6,921,753	
Department of Personnel Service Fund				11,501,003	4,129,830	
General Administration Facilities &						
General Administration Personnel Services Revolving Fund	(163,400)	77,125	20,258,369	19,432,557	902,937	
Higher Education Personnel Board Service Fund	226,576	441,665	5,842,148	5,791,706	492,107	
General Administration Management						
Legal Services Revolving Fund	23,604	18,472	2,110,537	1,780,456	348,553	
Municipal Revolving Fund	(8,589)	695,925	31,710,914	32,068,395	338,444	
Salary and Health Increase- Dedicated Funds	234,475	277,934	13,447,104	13,650,208	74,830	
Secretary of State Revolving Fund	(145,309)	—	47,707,448	47,707,448	—	
State Employees' Insurance Fund	79,829	22,266	412,458	417,170	17,554	
State Treasurer's Service Fund	1,636,831	2,077,432	2,293,987	1,821,213	2,550,206	
	4,995,533	4,392,472	7,610,029	7,702,802	4,299,699	
TOTAL Working Capital	15,837,561	17,434,429	248,868,183	245,877,087	20,425,525	
BUSINESS ENTERPRISE						
Liquor Board Revolving Fund	2,681,146	2,568,671	132,783,894	132,106,680	3,245,885	

	6/30/83 Actual Balance	6/30/85 Estimated Balance	1985-87 Proposed Revenue	1985-87 Proposed Expenditures	6/30/87 Estimated Balance
TRUST AND AGENCY					
Accident Fund	—	—	75,787,079	75,787,079	—
Business Enterprises Revolving Fund	160,489	1,084,831	—	—	—
Deferred Compensation Revolving Fund	760,457	1,544,620	530,350	1,240,134	375,047
Gambling Revolving Fund	2,642,143	—	7,674,259	7,235,426	1,983,453
Medical Aid Fund	—	—	73,889,824	73,889,824	—
Plumbing Certificate Fund	314,280	301,991	331,973	435,965	197,999
Pressure Systems Safety Fund	307,930	202,784	1,293,767	1,069,477	427,074
Public Facilities Construction					
Loan Account	1,348,993	555,147	304,158	242,077	617,228
Radiation Perpetual Maintenance Fund	—	32,692	—	—	32,692
Retirement System Expense Fund	- 509,748	1,670,123	13,574,466	14,393,691	850,898
Teacher's Retirement Fund	—	—	—	—	—
Volunteer Firemen's Relief and Pension Fund	1,839,265	2,536,797	958,023	205,628	3,289,192
Wash. Library Network Computer System Revolving Fund	448,278	126,000	13,599,883	12,856,731	869,152
TOTAL TRUST and Agency	8,331,583	8,054,985	187,943,782	187,356,032	8,642,735
TOTAL TREASURY FUNDS— CASH SURPLUS	479,460,698	488,959,481	16,467,199,331	16,407,716,078	548,422,734
	* * *				

EXHIBIT 24

Exhibit No. — entitled Summary Report With Respect to SB 3677 was prepared by the Department of Revenue in anticipation of possible revenue legislation which might have been submitted to the 49th session of the Washington State Legislature in 1985. The possibility of such legislation was proposed by Governor Booth Gardner in a public announcement. A draft of such legislation to which the exhibit report is directed was prepared by the Office of the Code Reviser. The legislation, however, was not formally introduced and thus was not considered by any legislative committee in hearing or in other action nor was it acted upon by either house of the Washington State Legislature.

SENATE BILL NO. 3677**SUMMARY:**

This bill provides a guaranteed source of funding for the budget stabilization account and additional revenues for the 1985-87 biennium.

The budget stabilization account is funded by extending the retail sales tax to motor vehicle fuel. The tax is computed on the basis of the price at the pump, including state and federal taxes imposed at the distributor level. The tax is estimated to raise \$375 million during the 1985-87 biennium. It will be effective June 1, 1985.

When the budget stabilization account reaches \$300 million the state sales tax rate will automatically be reduced to 6 percent. Funds in the budget stabilization account may be appropriated by majority vote of the legislature.

The bill also increases the B&O tax rate on services from 1.5 percent to 2 percent, effective May 1, 1985. This increase will raise an additional \$6.3 million in the 1983-85 biennium and \$153.6 in the 85-87 biennium. The regular B&O rate on medical services will be reduced to 1.5 percent for medical practitioners subject to the additional 1 percent B&O tax imposed to fund Senator McDermott's health care cost containment program, Senate Bill 3320.

The revenues to be raised by this bill are as follows (in millions):

	83-85	85-87
Budget Stabilization Acct.		
Sales tax m.v. fuel	\$-0-	\$300
General Fund		
Service B&O tax	6.3	160.3
S.B. 3320 (eff. 7-1-86)	-0-	(6.7)
Sales tax reduction (eff. 1-1-87)		(79.0)
	<hr/> \$6.3	<hr/> \$74.6

Department of Revenue

April 8, 1985

Contact Matt Coyle, Deputy Director
753-4196

SENATE BILL 3677

Section by Section Analysis

- Section 1. Eliminates the sales tax exemption for motor vehicle and special fuel. The sales tax will be computed on the basis of the price at the pump, including state and federal excise taxes imposed at the distributor level.
- Section 2. Removes the corresponding use tax (RCW Ch. 82.12) exemption for motor vehicle and special fuel.
- Section 3. Increases the B&O tax rate on real estate commissions from 1.5 percent to 2 percent. This B&O rate has historically been the same as the service rate. Effective May 1, 1985.
- Section 4. Increases the B&O tax rate on services from 1.5 percent to 2 percent, effective May 1, 1985. Provides for a reduction in the B&O rate to 1.5 percent for medical practitioners subject to

the additional 1 percent B&O tax used to fund health care costs under SB 3320.

- Section 5. Provides that sales tax receipts from motor vehicle and special fuels are to be deposited in the budget stabilization account.
- Section 6. Provides that use tax receipts from motor vehicle and special fuels are to be deposited in the budget stabilization account.
- Section 7. Provides for a reduction in the sales tax rate from 6.5 percent to 6 percent when the budget stabilization account reaches \$300 million. (See Sec. 12)
- Section 8. A technical correction. Deletes references to the OFM Director's duty to provide for transfers and repayments to the budget stabilization account. (See Subsection 1(e)) This authority is no longer needed.
- Section 9. Amends RCW 43.88.525 to create a new budget stabilization account in the state treasury. Deletes references to the previous budget stabilization account and attendant duties which are no longer necessary.
- Section 10. Amends RCW 43.88.535 to provide that funds in the budget stabilization account may be appropriated by majority vote rather than a sixty percent vote. Deletes authority to waive deposits in the account in the event of an expenditure from the account.
- Section 11. Repeals RCW 43.88.530 and .540, dealing with the former budget stabilization account. Because revenues for the account are guaranteed from the sales tax on motor vehicle fuel, these provisions are no longer necessary.
- Section 12. Provide a \$300 million cap for the budget stabilization account. When the balance in the account reaches \$300 million, the general sales

tax rate is reduced from 6.5 percent to 6 percent, and sales and use tax receipts from motor vehicle and special fuel become available to the general fund.

Section 13. Provides for effective dates.

Sales and use tax on motor vehicle fuel—June 1, 1985

½ percent B&O tax increase—May 1, 1985

SUPREME COURT OF THE UNITED STATES

No. 85-2006

National Can Corporation, et al.,

Appellants

v.

Washington State Department of Revenue

APPEAL from the Supreme Court of Washington,

The statement of jurisdiction in this case having been submitted and considered by the Court, probable jurisdiction is noted. This case is consolidated with 85-1963, *Tyler Pipe Industries, Inc. v. Washington Department of Revenue* a total of one hour is allotted for oral argument.

October 6, 1986

Justice Powell and Justice Scalia took no part in the consideration or decision of this petition.

10
12
Supreme Court, U.S.
FILED

Nos. 85-1963 and 85-2006

FEB 20 1987

OCEPH F. SPANIOL, JR.

In The
Supreme Court of the United States
October Term, 1986

TYLER PIPE INDUSTRIES, INC.,
Appellant,

v.

STATE OF WASHINGTON
DEPARTMENT OF REVENUE,
Appellee.

—o—
NATIONAL CAN CORPORATION, *et al.*,
Appellants,

v.

STATE OF WASHINGTON
DEPARTMENT OF REVENUE,
Appellee.

—o—
**ON APPEAL FROM THE
SUPREME COURT OF WASHINGTON**
—o—

JOINT APPENDIX—VOL. II

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*Counsel of Record

Appeal Docketed—Case No. 85-1963, May 30, 1986

Appeal Docketed—Case No. 85-2006, June 3, 1986

Probable Jurisdiction Noted October 6, 1986

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SUPREME COURT OF THE UNITED STATES

NATIONAL CAN CORPORATION, et al.,

Appellants,

v.

STATE OF WASHINGTON,
DEPARTMENT OF REVENUE,

Appellee.

AFFIDAVIT OF
RICHARD F. JONES

STATE OF WASHINGTON
County of Thurston } ss.

I, Richard F. Jones, being first duly sworn, upon oath
state that:

1. I am the Reporter of Decisions for the Washington
State Supreme Court, responsible for the official publication
of decisions of that Court.

2. One of those decisions, *National Can Corporation, et al. v. The Department of Revenue*, 105 Wn.2d 327 (1986), is currently being prepared for hardbound publication. I was directed by the Court to change a portion of the opinion, 105 Wn.2d at 334, to correct its references to the West Virginia manufacturing and wholesaling tax rates. I have made that correction for the hardbound publication.

3. Attached hereto is a true and correct copy of the
National Can decision as approved for final publication and
as it will appear in the hardbound volume of Washington
Reports.

/s/

Richard F. Jones

SUBSCRIBED AND SWORN TO before me this 13
day of February, 1987.

/s/

Sharon McCall
NOTARY PUBLIC in and for
the State of Washington resid-
ing in Olympia.

[No. 51910-2. En Banc. March 6, 1986.]

NATIONAL CAN CORPORATION, ET AL, *Appellants*, v.
THE DEPARTMENT OF REVENUE, *Respondent*.

[1] **Taxation — Interstate Business — Commerce Clause — Discrimination — Compensating Taxes — Validity.** A state tax on interstate business different from the tax imposed on purely local business meets the nondiscrimination mandate of the com-

merce clause if the two taxes are compensatory.

- [2] **Taxation — Interstate Business — Commerce Clause — Discrimination — Compensating Taxes — Test.** Two taxes imposed respectively on local and interstate taxpayers are compensatory, for purposes of the nondiscrimination mandate of the commerce clause, if both taxes have the same legislative objective and local and interstate taxpayers receive equal treatment.
- [3] **Taxation — Business and Occupation Tax — Interstate Business — Multiple Activities Exemption.** RCW 82.04.440, which provides that persons taxed under RCW 82.04.270 as local wholesalers shall not be taxed under RCW 82.04.240 as manufacturers, does not unconstitutionally discriminate against interstate commerce, and does not violate the apportionment or fairly-related requirements of the commerce clause.
- [4] **Taxation — Interstate Business — Commerce Clause — Apportionment — Gross Proceeds.** A state tax on the privilege of doing business in the state is fairly apportioned as required by the commerce clause if the measure of the tax is the gross value of products manufactured in the state or the gross proceeds of sales in the state.
- [5] **Taxation — Interstate Business — Commerce Clause — Fairly Related.** A state tax on the privilege of doing business in the state is fairly related to the services provided, as required by the commerce clause, if the taxpayer enjoys the privileges of the societal organization supported generally by taxes collected by the state.

Nature of Action: Various taxpayers sought refunds of business and occupation taxes paid, asserting invalidity of the tax under the commerce clause.

Superior Court: The Superior Court for Thurston County, No. 84-2-01900-7, Orris L. Hamilton, J. Pro Tem., entered a summary judgment on July 19, 1985, upholding the tax.

Supreme Court: Holding that the tax was not invalid under the commerce clause as construed by a recent United States Supreme Court opinion, the court *affirms* the judgment.

Bogle & Gates, John T. Piper, D. Michael Young, Franklin G. Dinges, and James R. Johnston, for appellants.

Kenneth O. Eikenberry, Attorney General, and William B. Collins, Assistant, for respondent.

UTTER, J.—This is a direct appeal from the trial court where various commercial enterprises (Taxpayers) claimed Washington's multiple activities exemption to the business and occupation (B & O) tax, RCW 82.04.440, discriminates against interstate commerce in violation of the commerce clause, U.S. Const. art. 1, § 8. The trial court ruled there was no unlawful discrimination. We agree and hold for the respondent, Department of Revenue, that the challenged exemption does not violate the commerce clause. Our holding makes it unnecessary to reach the other issues raised by the parties concerning the constitutionality of both the tax refund interest provision, RCW 82.32.060, and the proposed legislation, ESSB 3678, as well as the appropriate form of relief to be afforded Taxpayers.

Fifty-three separate actions for refunds of B & O taxes paid to the Department were filed. Each Taxpayer claimed the tax violates the commerce clause. These actions were joined for decision by the Thurston County Superior Court which granted the Department's motion for summary judgment and denied the Taxpayers' motions for injunctions against further collection of the B & O taxes in question. The 53 cases were consolidated for this appeal and, in addition, 52 other substantially similar actions are pending in Thurston County Superior Court. The amount in question is estimated to exceed \$423 million.

Three plaintiffs were selected by the parties to serve as "test cases" in the appeal. Kalama Chemical, Inc., a representative plaintiff, manufactures its products in Washington and sells them outside of Washington. Xerox Corporation, the second representative plaintiff, manufactures its products outside Washington and sells them within Washington. The appellant in a companion case would appear to fit most closely within this category of plaintiffs. See *Tyler Pipe Indus., Inc. v. Department of Rev.*, 105 Wn.2d 318, 715 P.2d 123 (1986). National Can

Corporation, the third representative plaintiff, manufactures products in Washington for sale outside Washington, and also manufactures products outside Washington for sale in Washington. Kalama Chemical, Inc., seeks a refund of the manufacturing tax it paid (\$495,000); Xerox Corporation seeks a refund of the wholesale tax it paid (\$1.5 million); National Can Corporation seeks a refund of both the manufacturing and wholesale taxes it paid (approximately \$900,000). The period in dispute is from 1980 to the present.

The issue before us is whether Washington's B & O tax exemption, RCW 82.04.440, violates the commerce clause because it (1) discriminates against interstate commerce, (2) is unfairly apportioned, or (3) is not fairly related to the services provided by the State.

Neither this court, nor the State Legislature, "is the final arbiter" of commerce clause issues. See *Southern Pac. Co. v. Arizona ex rel. Sullivan*, 325 U.S. 761, 89 L. Ed. 1915, 65 S. Ct. 1515 (1945). In an earlier challenge to this B & O tax, we recognized "our duty [is] to abide by controlling United States Supreme Court decisions construing the federal constitution." *Association of Wash. Stevedoring Cos. v. Department of Rev.*, 88 Wn.2d 315, 318, 559 P.2d 997 (1977), *rev'd*, 435 U.S. 734, 55 L. Ed. 2d 682, 98 S. Ct. 1388 (1978). This court's rulings on the constitutionality of the Washington B & O tax have generally withstood the United States Supreme Court's scrutiny, see, e.g., *General Motors Corp. v. Washington*, 377 U.S. 436, 12 L. Ed. 2d 430, 84 S. Ct. 1564 (1963); *Standard Pressed Steel Co. v. Department of Rev.*, 419 U.S. 560, 42 L. Ed. 2d 719, 95 S. Ct. 706 (1975), except when we have read the commerce clause too broadly and struck down the tax. See *Association of Wash. Stevedoring Cos. v. Department of Rev.*, 88 Wn.2d at 318-20.

We find ourselves today in a similar situation. For over 30 years, Washington's B & O tax has been repeatedly upheld by the federal courts against charges that it discriminated against interstate commerce. See *B.F. Goodrich Co. v. State*, 38 Wn.2d 663, 231 P.2d 325, *cert. denied*, 342

U.S. 876, 96 L. Ed. 659, 72 S. Ct. 167 (1951). In *B.F. Goodrich*, we held that the B & O tax does not discriminate against interstate commerce because, under that law, all wholesalers are taxed identically. We relied on the theory that any multiple-tax burdens on interstate commerce, whereby out-of-state businesses must pay a manufacturing tax in another state plus a wholesale tax in Washington, were merely "an inevitable consequence of the power of the several states to tax". 38 Wn.2d at 669; see also *General Motors Corp. v. State*, 60 Wn.2d 862, 376 P.2d 843 (1962) (B & O tax upheld against charges of discrimination, applying the *Goodrich* analysis). The Supreme Court affirmed, *General Motors Corp. v. Washington*, 377 U.S. 436, 12 L. Ed. 2d 430, 84 S. Ct. 1564 (1964), but specifically declined to pass on the question of discrimination in the form of multiple-tax burdens because the appellant there failed to demonstrate any actual multiple-tax burden by showing that another state levied an equivalent tax.

In *Chicago Bridge & Iron Co. v. Department of Rev.*, 98 Wn.2d 814, 832, 659 P.2d 463, *appeal dismissed*, 464 U.S. 1013 (1983), this court upheld the tax against charges of discrimination in the form of multiple-tax burdens. The court cited *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 277 n.12, 57 L. Ed. 2d 197, 98 S. Ct. 2340 (1978) for the proposition that the multiple-tax burdens experienced by interstate businesses are a "consequence of the combined effect of different states' laws" and were not caused by Washington's taxing scheme. 98 Wn.2d at 832. The United States Supreme Court dismissed the subsequent appeal "for want of a federal question," *Chicago Bridge & Iron Co. v. Washington Dep't of Rev.*, 464 U.S. 1013, 78 L. Ed. 2d 718, 104 S. Ct. 542 (1983), which we understand to be a decision on the merits. *Washington v. Confederated Bands & Tribes of Yakima Indian Nation*, 439 U.S. 463, 476 n.19, 58 L. Ed. 2d 740, 99 S. Ct. 740, *reh'g denied*, 440 U.S. 940, 59 L. Ed. 2d 500, 99 S. Ct. 1290 (1979).

Taxpayers assert, however, that a recent Supreme Court case, *Armco Inc. v. Hardesty*, 467 U.S. 638, 81 L. Ed. 2d

540, 104 S. Ct. 2620 (1984),¹ effectively overrules, *sub silentio*, these 30 years of Supreme Court doctrine. As a result of their reading of *Armco*, Taxpayers ask this court to strike down the state's B & O tax and refund all moneys allegedly improperly received under it since 1980.

Due to factual differences between the West Virginia tax, challenged in *Armco*, see 467 U.S. at 640, and the Washington tax, we do not believe the United States Supreme Court is requiring us to forge new commerce clause doctrine and disregard earlier decisions not overruled. We are unable to find such a command in the *Armco* decision. We are also troubled by the "free-rider" effect of Taxpayers' argument. As Taxpayers conceded at oral argument, their interpretation of *Armco* would force the State to forgo taxing a substantial number of in-state transactions where state services had admittedly been furnished. This implies that a state, to make up the deficit, must impose a double tax burden on in-state manufacturer-wholesalers.

THE COMMERCE CLAUSE ISSUES

RCW 82.04.220 imposes, in general, a tax upon the privilege of engaging in business activities in Washington. The tax is measured by the application of rates against (1) the value of the products, (2) gross proceeds of sales, or (3) the gross income of the business, whichever is applicable. RCW 82.04.240 imposes a tax upon Washington manufacturers. RCW 82.04.270 taxes every person who sells products at wholesale in Washington. The disputed provision, RCW 82.04.440, provides that persons taxable under RCW 82.04-

¹The decision has already provoked considerable comment. See Judson & Duffy, *An Opportunity Missed: Armco, Inc. v. Hardesty, A Retreat From Economic Reality in Analysis of State Taxes*, 87 W. Va. L. Rev. 723 (1985); Lathrop, *Armco—A Narrow and Puzzling Test for Discriminatory State Taxes Under the Commerce Clause*, Taxes 551 (Aug. 1985); Lightburn & McArthur, *U.S. Supreme Court Ignores Unitary Issue in Armco, Inc. Opting for Discriminatory Finding*, 3 J. of St. Tax'n 211 (1984); Note, *A Call for Internal Consistency Among State Taxing Schemes: Armco, Inc. v. Hardesty*, 38 Tax Law. 519 (1985); Sup. Ct. Holds West Virginia's Wholesale Gross Receipts Tax Unconstitutional, Tax Adviser 487 (Aug. 1984); *West Virginia Gross Receipts Tax Discriminates Against Interstate Commerce*, 3 J. of St. Tax'n 143 (1984).

.270 (wholesalers) shall not be taxed under RCW 82.04.240 (as local manufacturers). Thus, local manufacturers who wholesale their products strictly in Washington pay only the wholesaling tax. Further, a local extractor of a product who wholesales in Washington pays only the wholesaling tax, just as do out-of-state extractors. RCW 82.04.440. Under RCW 82.04.240, in-state manufacturers and extractors who sell their products out of state pay only the manufacturing tax, at a rate substantially identical to that paid by in-state wholesalers.

A state B & O tax must pass a 4-prong test to be valid under the commerce clause: (1) There must be a sufficient *nexus* or connection between the taxing state and the activities taxed; (2) the tax must be *fairly apportioned*; (3) the tax cannot *discriminate* against interstate commerce in favor of local commerce; and (4) the tax must be *fairly related* to the services provided by the taxing state. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 51 L. Ed. 2d 326, 97 S. Ct. 1076 (1977); *Department of Rev. v. Association of Wash. Stevedoring Cos.*, 435 U.S. 734, 55 L. Ed. 2d 682, 98 S. Ct. 1388 (1978). Appellants contend that Washington's B & O tax fails the last three prongs of this test. Because the heart of Taxpayers' complaint is that the statute fails the third prong, discrimination, that issue is addressed first. The second (fairly apportioned) and fourth (fairly related) prongs will be addressed together. Nexus is not at issue in this case, but is contested in the companion case. See *Tyler Pipe Indus., Inc. v. Department of Rev.*, 105 Wn.2d 318, 715 P.2d 123 (1986).

A

DISCRIMINATION

[1] A state's taxing scheme is discriminatory under the commerce clause if it grants a direct commercial advantage to local businesses or subjects interstate commerce to a risk of multiple tax burdens, to which strictly local commerce is not exposed. See *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 50 L. Ed. 2d 514, 97 S. Ct. 599 (1977); *Gwin*,

White & Prince, Inc. v. Henneford, 305 U.S. 434, 83 L. Ed. 272, 59 S. Ct. 325 (1939). Any direct commercial advantage to local businesses inherent in Washington's B & O tax results from duplicative tax burdens; e.g., the fact that strictly local businesses pay only one tax (either wholesale or manufacturing), while interstate businesses may possibly be subjected to one tax in this state and another tax at a different level of distribution in another state. Appellants contend that the recent Supreme Court decision, *Armco Inc. v. Hardesty*, 467 U.S. 638, 81 L. Ed. 2d 540, 104 S. Ct. 2620 (1984), controls where there is a possibility of multiple-tax burdens and requires the invalidation of Washington's B & O tax.

In *Armco*, the Court invalidated West Virginia's gross receipts tax, under which local manufacturers were exempted from payment of the wholesale tax when they sold their locally manufactured products in West Virginia. Out-of-state manufacturers were required to pay the West Virginia wholesale tax when they sold their products in that state.

West Virginia's gross receipts tax is claimed to be the mirror image of Washington's present tax. West Virginia granted strictly local manufacturer-wholesalers an exemption from its wholesale tax; Washington grants strictly local manufacturer-wholesalers an exemption from its manufacturing tax. Besides providing an exemption to taxpayers who have already paid one state excise tax, the two tax systems are similar in that they are gross receipts taxes.² Their points of difference, however, have become more noteworthy after the *Armco* decision. The West Virginia tax exacted substantially different tax rates on manufacturing (.88 percent) and wholesaling activities (.27 percent), which precluded the Court from finding that the wholesal-

²The similarities were acknowledged by the Department when it was before the *Armco* Court. See *Armco*, 467 U.S. at 645. In oral argument before this court, however, the Department stated that the *Armco* opinion, with its emphasis on the rates and measures of the West Virginia tax, makes the differences between the two states' taxes more significant than their similarities.

ing tax compensated for the manufacturing tax. *Armco*, 467 U.S. at 642. By exacting substantially identical rates (.44 percent) for each activity, the Washington tax does not present the same obstacle to finding the taxes are compensatory.

In *Armco*, the Court held that West Virginia's tax facially discriminated against interstate commerce, 467 U.S. at 641, because it provided that "two companies selling . . . property at wholesale . . . will be treated differently depending on whether the taxpayer conducts manufacturing in the State or out of it." *Armco*, 467 U.S. at 642. The Court further determined that under the West Virginia tax scheme the manufacturing and wholesaling were not "substantially equivalent events" which would allow for the imposition of compensating taxes. *Armco*, 467 U.S. at 643. It also noted that West Virginia did not allow for a proportionate reduction of its manufacturing tax when the manufactured goods were sold out of state, but did allow such a reduction when the goods were partly manufactured out of state. This was taken as evidence that the manufacturing tax was "not in part a proxy for the gross receipts tax imposed on Armco . . ." 467 U.S. at 643.

[2] While the Court did not explain what it meant by "substantially equivalent events,"³ its reliance on *Maryland v. Louisiana*, 451 U.S. 725, 758-60, 68 L. Ed. 2d 576, 101 S. Ct. 2114 (1981) indicates a criterion to guide us in determining when the selling and wholesaling taxes would be deemed compensatory and therefore substantially equivalent. In *Maryland v. Louisiana*, *supra*, Louisiana claimed its first-use tax compensated for a severance tax the State had imposed on local natural gas production. The first-use tax fell primarily on gas produced in the federal Outer Continental Shelf (OCS) and piped to Louisiana

³That the rate varies slightly for various types of businesses is not germane to the present issue. The variance comes from a subsequently enacted surtax. RCW 82.04.2904. Moreover, mathematical equality is not required. *General Am. Tank Car Corp. v. Day*, 270 U.S. 367, 373, 70 L. Ed. 635, 46 S. Ct. 234 (1926).

processing plants before being distributed to out-of-state consumers. The Court stated the 2-pronged criterion for determining compensatory taxes: (1) both taxes must be designed to meet the same ends; (2) local and interstate taxpayers similarly situated must receive equal treatment. 451 U.S. at 758-59.

The Louisiana tax failed on both prongs of the test. The purpose of the severance tax was to protect Louisiana's natural resources and compensate for their depletion. The first-use tax, however, could not be designed for that same purpose, "since Louisiana has no sovereign interest in being compensated for the severance of resources from the federally owned OCS land." 451 U.S. at 759. The Court also noted that Louisiana's first-use tax directly altered market forces in three impermissible ways: (1) certain local uses of OCS gas were exempted from the tax; (2) its credit system encouraged "natural gas owners involved in the production of OCS gas to invest in mineral exploration and development within Louisiana" rather than continue to pursue out-of-state, e.g., OCS, development; (3) the credit system also assured that in-state end users of OCS gas would be insulated from the cost increases resulting from the first-use tax. 451 U.S. at 757.

None of the skewed market behavior due to the Louisiana tax appears to have developed in West Virginia. The *Armco* Court, however, found that the lack of symmetry in the West Virginia tax structure demonstrated that the selling and manufacturing taxes did not share the same end. 467 U.S. at 642-43. That West Virginia apportioned its manufacturing tax according to the percentage of in-state manufacturing a particular product represented, meant that West Virginia's selling tax could not be a substantially equivalent event for the manufacturing tax. In contrast, however, the flat rate character of the Washington taxes is evidence of the Legislature's intent to treat the two taxes as complementary and, therefore, compensatory.

[3] Furthermore, the Washington B & O tax does not exhibit the infirmities that led the Court in *Maryland v.*

Louisiana, supra, to conclude the first-use tax could not be a compensatory tax for the state's severance tax. The Washington B & O tax is designed to tax the privilege of engaging in business activity *within* the state. RCW 82.04-.220. Both the selling and the manufacturing taxes are exacted to address the same state burdens attendant on granting such a privilege. All who engage in selling activity within Washington pay the selling B & O tax, while those in-state manufacturers who sell out of state are taxed on their manufacturing activity. Each Taxpayer is taxed only once, at a substantially uniform rate,⁴ unlike West Virginia, for the privilege of doing business in Washington.

Nor does the tax exhibit a discriminatory impact. Unlike the Louisiana tax, the market forces are not altered by the incidence of the tax. In-state manufacturers selling out of state do not gain a tax advantage by shifting sales of their product to the local market. Similarly, out-of-state manufacturers selling in state gain no tax advantage by moving their manufacturing operations in state. Also in contrast with the Louisiana tax is the fact that in-state consumers are not insulated from the price effects of the tax on the goods.

We are further persuaded that the Washington tax is valid because it is conceptually identical to the pre-1968 New York stock transfer tax the Court endorsed in *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 50 L. Ed. 2d 514, 97 S. Ct. 599 (1977) which was in turn reaffirmed in *Armco*, 467 U.S. at 642. *Boston Stock Exchange* involved New York's attempt to keep the New York Stock Exchange by amending the stock transfer tax so that nonresidents who completed transfers entirely in New York paid a lower

⁴By way of example, the Court did suggest that sale and use taxes fell on substantially equivalent events. Other than representing activities farther downstream in the distribution chain, we do not see an economically significant difference between "sale and use" and "manufacturing and sale." *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 51 L. Ed. 2d 326, 97 S. Ct. 1076 (1977) requires some relationship between a legal distinction and "economic realities." 430 U.S. at 279.

tax than would residents, and that transfers occurring entirely within New York could only be taxed to a maximum of \$300, while there was no ceiling on other transfers. The tax was patently discriminatory and, unlike the B & O tax, was not part of a larger tax structure. The Court, however, spoke favorably of the unamended statute that taxed residents and nonresidents alike on one of several taxable stock transactions that could occur within the state. For both kinds of taxpayers, "the occasion of the tax was the occurrence of at least one taxable event in the State, the rate of tax was based solely on the price of the securities, and the total tax was determined by the number of shares sold." 429 U.S. at 322-23.

The *Armco* Court relied heavily upon the *Boston Stock Exchange* case as authority for striking down the West Virginia tax. *Boston Stock Exchange's* favorable treatment of the pre-1968 amendments, see 429 U.S. at 330, and the apparent centrality of that holding to *Armco* requires harmonization of the two opinions. The incongruities between Taxpayers' reading of *Armco* and earlier, well established commerce clause cases, see, e.g., *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 69 L. Ed. 2d 884, 101 S. Ct. 2946 (1981); *Complete Auto*; *Boston Stock Exchange*, makes us reluctant to extend *Armco* as Taxpayers urge. There is a disturbing formalism in their argument that manufacturing and wholesaling are never "substantially equivalent events." To read *Armco* thusly would foreclose analyzing a taxpayer's burden in light of both the structure of the relevant tax system and its effect on a single economic unit. Appellants' argument would force us to regard the gross receipts tax system as consisting of two separate taxes, manufacturing and selling, and to retreat from the *Complete Auto* "practical effects" test which *Armco* does not overrule or claim to modify. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 51 L. Ed. 2d 326, 97 S. Ct. 1076 (1977). To do so would be to ignore the "economic realities," 430 U.S. at 279, that a business unit frequently operates at several levels in the distribution chain and the costs

of those various operations come to bear on the single product which serves as the measure of taxation. See also Judson & Duffy, *An Opportunity Missed: Armco, Inc. v. Hardesty, A Retreat From Economic Reality in Analysis of State Taxes*, 87 W. Va. L. Rev. 723, 741 (1985); Lathrop, *Armco—A Narrow and Puzzling Test for Discriminatory State Taxes Under the Commerce Clause*, Taxes 551, 552, 559 (Aug. 1985).

Similarly, to avoid other incongruities posed by Taxpayers' arguments, we do not read *Armco* as requiring that the "internal consistency" requirement be applied to determine discrimination. The concept, "internal consistency," originated in the fair apportionment analysis of a multi-state net income tax case, *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 169, 77 L. Ed. 2d 545, 103 S. Ct. 2933 (1983), and its applicability to gross receipts tax cases has been questioned. See Lathrop, at 557. Nevertheless, the concept seems to have been used only to determine whether *Armco* Inc., had to show actual harm once it had demonstrated the tax provision was facially discriminatory. See Judson & Duffy, 87 W. Va. L. Rev. at 739. As we have previously discussed, however, Washington's tax is not facially discriminatory. We note further that the Court, were it to have grafted the concept onto the discrimination prong, would have obscured the *Complete Auto* test by treating the "multiple taxation" apportionment prong as a discrimination problem. Reflecting its greater complexity, the "fair apportionment" prong has been subject to more generous standards than has the discrimination prong. See, e.g., *Container Corp.*, 463 U.S. at 170; *Moorman Mfg. v. Bair*, 437 U.S. 267, 278, 57 L. Ed. 2d 197, 98 S. Ct. 2340 (1978).

Because the West Virginia and Washington taxes differ significantly, we must reject appellants' argument and rely on the long history of the United States Supreme Court's treatment of this state's gross receipts tax as having withstood commerce clause challenges, see *Department of Rev. v. Association of Wash. Stevedoring Cos.*, 435 U.S. 734, 55 L. Ed. 2d 682, 98 S. Ct. 1388 (1978); *Standard Pressed*

Steel Co. v. Department of Rev., 419 U.S. 560, 42 L. Ed. 2d 719, 95 S. Ct. 706 (1975); *General Motors Corp. v. Washington*, 377 U.S. 436, 12 L. Ed. 2d 430, 84 S. Ct. 1564 (1964); *Chicago Bridge & Iron Co. v. Department of Rev.*, 98 Wn.2d 814, 659 P.2d 463, *appeal dismissed*, 464 U.S. 1013 (1983); *Crown Zellerbach Corp. v. State*, 45 Wn.2d 749, 278 P.2d 305 (1954); *B.F. Goodrich Co. v. State*, 38 Wn.2d 663, 231 P.2d 325, *cert. denied*, 342 U.S. 876, 96 L. Ed. 659, 72 S. Ct. 167 (1951), as well as the general development of commerce clause analysis from *Complete Auto* to *Armco*. See, e.g., *Container Corp. of Am. v. Franchise Tax Bd.*, *supra*; *Commonwealth Edison Co. v. Montana*, *supra*; *Maryland v. Louisiana*, *supra*; *Moorman Mfg. Co. v. Bair*, *supra*. Under these two lines of precedent, we do not find the tax discriminatory.

B

FAIR APPORTIONMENT; TAX FAIRLY RELATED TO SERVICES PROVIDED BY THE STATE

Taxpayers also claim that Washington's B & O tax violates the commerce clause because it is not fairly apportioned to reflect the amount of business conducted here, and it is not fairly related to the services rendered by Washington. As a result, Taxpayers complain that they are unfairly taxed upon more than 100 percent of their incomes. Hence, under the second and fourth prongs of the *Complete Auto* test, Taxpayers claim that interstate businesses are improperly subjected to multiple-tax burdens.

1. Fair Apportionment

Most apportionment cases have arisen in challenges to state income taxes where the income of a unitary multi-state business comes from a variety of tax jurisdictions. As Judson and Duffy note, a B & O tax on business activity within the state does not present the same difficulty in determining a nexus between business activity and the tax jurisdiction. Judson & Duffy, 87 W. Va. L. Rev. at 728. Moreover, even in the income tax cases, the Court has afforded legislatures a generous standard. In *Exxon Corp.*

v. Wisconsin Dep't of Rev., 447 U.S. 207, 219-20, 65 L. Ed. 2d 66, 100 S. Ct. 2109 (1980), the Court looked only to whether there was "a rational relationship between the income attributed to the State and the intrastate values of the enterprise." See also, e.g., *Container Corp. of Am. v. Franchise Tax Bd.*, *supra*. Earlier, the *Moorman* Court had refused to require Iowa to employ the favored 3-factor test, urged here by Taxpayers, instead of its single-factor test for apportioning interstate commerce income. To disturb the formula, the taxpayers in *Moorman* would have to show by "'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportions to the business transacted . . . in that State' . . . or has 'led to a grossly distorted result' . . ." 437 U.S. at 274. The mere threat that income not generated in the state will be taxed under a formula does not make the formula constitutionally defective. 437 U.S. at 278. Congress, not the Court, must enact national uniform rules for the division of income if it finds duplicative taxation a problem. 437 U.S. at 279.

Washington's B & O tax has been held to be fairly apportioned in previous cases. See *Department of Rev. v. Association of Wash. Stevedoring Cos.*, *supra*; *Standard Pressed Steel Co. v. Department of Rev.*, *supra*; *Chicago Bridge & Iron Co. v. Department of Rev.*, *supra*. Nonetheless, Taxpayers urge that, under *Armco*, the tax must now pass the "internal consistency" test articulated in *Container Corp. of Am. v. Franchise Tax Bd.*, *supra*, and cited in *Armco*. In applying that test, the court must hypothesize that every jurisdiction has adopted a tax identical to the tax in question; the result must be that no more than 100 percent of a single business's income is taxed by one state.

We agree with the Department that the "internal consistency" test articulated in *Container Corp.* and *Armco* does not apply to the determination whether the B & O tax is fairly apportioned. This is because Washington does not tax the income of a unitary business, but rather taxes only the privilege of manufacturing or selling within the state.

Thus, respondent urges that Washington's tax is apportioned by "allocation"; that is, the tax is applied only to the value of products manufactured in Washington or to the gross proceeds of sales in Washington.

[4] We do not read the *Armco* opinion to apply its "internal consistency" test to the question of whether a state gross receipts tax is fairly apportioned. We believe that it does not apply not only because of the appeal of the Department's argument, but because the *Armco* Court said nothing about the status of *Department of Rev. v. Association of Wash. Stevedoring Cos.*, 435 U.S. 734, 55 L. Ed. 2d 682, 98 S. Ct. 1388 (1978). If the "internal consistency" requirement applied to the fair apportionment prong, *Washington Stevedoring* should be overruled for requiring a showing of actual harm to make out unfair apportionment. 435 U.S. at 746 & n.16. Further, speaking specifically of the tax challenged here, the Court said, "[w]hen a general business tax levies only on the value of services performed within the State, the tax is properly apportioned and multiple burdens logically cannot occur." 435 U.S. at 746-47.

2. Fairly Related

[5] The *Armco* Court did not address the "fairly related to state services" prong. The controlling case is *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 69 L. Ed. 2d 884, 101 S. Ct. 2946 (1981). Certain Montana coal producers and their out-of-state customers argued that they should be permitted to show that the state's high coal severance tax was not fairly related to state services provided. The Court refused to view the fair relation test as a cost-benefit analysis of the taxes paid and services received. The test is basically a nexus test, with "the additional limitation that the measure of the tax must be reasonably related to the extent of the [taxpayer's] contact" with the state. 453 U.S. at 626. The Court declined to determine what a reasonable measure might be because (1) no usable legal test could adequately reflect the varied considerations that

"inform a decision about an acceptable rate or level of state taxation", 453 U.S. at 628; and, hence, (2) this is a question more suited to the political process. The taxpayer's "substantial privilege of mining coal" provided sufficient nexus and the only benefit the state needed to show was that the taxpayer enjoyed the "privileges of living in an organized society, established and safeguarded by the devotion of taxes to public purposes." 453 U.S. at 629. See also *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 60 L. Ed. 2d 336, 99 S. Ct. 1813 (1979).

Manufacturing, or wholesaling, would also appear to be privileges comparable to mining so that the nexus requirement is sufficiently met in the present case. Despite any warts Washington may suffer, the State can show that ours is "an organized society." While local manufacturer-sellers enjoy "two activities for the price of one", interstate businesses cannot, under this prong, apply a cost-benefit analysis to show how they have been short changed.

We believe the Washington B & O tax continues to meet commerce clause standards. We do not believe *Armco* requires the result urged by appellants and can be reconciled with compelling precedent not overruled in *Armco* and with scholarly commentary. We also believe the controlling facts in *Armco* differ significantly from those before us. The trial court is affirmed.

DOLLIVER, C.J., and BRACHENBACH, DORE, PEARSON, ANDERSEN, CALLOW, GOODLOE, and DURHAM, JJ., concur.

Supreme Court, U.S.

E I L E D

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NOV 20 1986

JOSEPH F. SPANNOLO, JR.
CLERK

No. 85-1963

IN THE

Supreme Court Of The United States
OCTOBER TERM, 1985

TYLER PIPE INDUSTRIES, INC.,

Appellant

vs.

STATE OF WASHINGTON DEPARTMENT OF REVENUE,

Appellee

**On Appeal from the
Supreme Court of Washington**

BRIEF OF APPELLANT

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November 20, 1986

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QUESTIONS PRESENTED

Sections 82.04.220 to 82.04.500, of the Revised Code of the State of Washington, impose a business and occupation tax upon persons engaged in, *inter alia*, wholesaling and manufacturing, measured by gross receipts received from the activity. Section 82.04.440 of the Revised Code provides an exemption from the manufacturing tax for persons engaged in manufacturing and wholesaling within the State of Washington.

The questions presented are:

1. Whether the tax imposed by these statutory provisions violates the Commerce Clause or the Due Process Clause of the United States Constitution, as applied to Appellant, because Appellant's connections with the State of Washington fail to satisfy constitutional standards with respect to sufficient minimal connection and substantial nexus?
2. Whether the Washington statutory scheme violates the Commerce Clause of the United States Constitution because the tax imposed discriminates against interstate commerce?
3. Whether the Washington statutory scheme violates the Commerce Clause or Due Process Clause of the United States Constitution because the tax imposed is not fairly apportioned, or is not fairly related to the services provided by the State of Washington, or is not rationally related to the values of Appellant in the State of Washington?

LIST OF PARTIES

The names of all parties to the proceedings below are reflected in the caption of the case. Pursuant to Supreme Court Rule No. 28.1, the Appellant, Tyler Pipe Industries, Inc., a Delaware corporation with its principal office in Tyler, Texas, states that it is a wholly-owned subsidiary of Tyler Corporation, a Delaware corporation with its principal place of business in Dallas, Texas. There are no other parent corporations, subsidiaries or affiliates of Appellant or Tyler Corporation other than wholly-owned subsidiaries of each.

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IN THE
Supreme Court Of The United States
OCTOBER TERM, 1985

TYLER PIPE INDUSTRIES, INC.,
Appellant
vs.
STATE OF WASHINGTON DEPARTMENT OF REVENUE,
Appellee

**On Appeal from the
Supreme Court of Washington**

BRIEF OF APPELLANT

November 20, 1986

Tyler Pipe Industries, Inc., Appellant, appeals from the final judgment of the Supreme Court of Washington rendered in this case on March 6, 1986.

OPINIONS BELOW

The opinion of the Supreme Court of the State of Washington (Jurisdictional Statement, pp. A-1 to A-9) is reported at 105 Wn.2d 318 and 715 P.2d 123. The opinion of the Superior Court for Thurston County, Washington (Jurisdictional Statement, pp. B-1 to B-5) is not officially reported. The determination and final determination of the State of Washington Department of Revenue (Jurisdictional Statement, pp. C-1 to C-11) are not officially reported. The opinion of the Supreme Court of the State of Washington in the companion case of *National Can Corporation v. State of Washington Department of Revenue*, (Jurisdictional Statement, pp. D-1 to D-16) is reported at 105 Wn.2d 327 and 715 P.2d 128.

JURISDICTION

Appellant brought this action in the Superior Court of Thurston County, Washington, seeking a refund of business and occupation taxes imposed by the State of Washington. The Supreme Court of Washington entered and filed its opinion and judgment on March 6, 1986, denying the refund. Appellant filed a notice of appeal in that court on April 15, 1986. This Court noted probable jurisdiction by Order of October 6, 1986. Jurisdiction of this Court rests upon 28 U.S.C. Section 1257(2).

STATEMENT OF THE CASE

A. Proceedings Below.

On December 26, 1980, the Department of Revenue for the State of Washington assessed business and occupation taxes (hereinafter referred to as "B&O taxes") for the period January 1, 1976, through September 30, 1980, against Appellant, Tyler Pipe Industries, Inc. On February 25, 1981, Tyler Pipe petitioned the Department of Revenue to correct the assessment on the grounds that imposition of the taxes against Tyler Pipe violated the Due Process and Commerce clauses of the United States Constitution and the Federal Interstate Income Tax Act, 15 U.S.C. Sections 381 to 384. The Department denied the petition on March 12, 1981. Tyler Pipe filed an administrative appeal of the Department's action on March 31, 1981, which was turned down by the Department on April 30, 1981. Tyler Pipe then sought a temporary injunction in the Superior Court for Thurston County, Washington, against the Department's collection of the assessment on May 20, 1981. The Superior Court granted the injunction on June 8, 1981. On January 4, 1982, the Supreme Court of the State of Washington reversed the grant of the injunction. Tyler Pipe's motion for reconsideration was denied by the Washington Supreme Court on March 2, 1982.

On March 10, 1982, Tyler Pipe paid the tax assessment and sued the State of Washington in the Superior Court for Thurston County, State of Washington, for refund of the tax on the grounds that assessment and collection of the tax violated the Due Process and Commerce clauses of the United States Constitution and the Federal Interstate Income Tax Act. On June 15, 1984, the Superior Court filed a memorandum opinion holding against Tyler Pipe. On August 6, 1984, the Superior Court denied Tyler Pipe's motion for reconsideration, stating that the Court's decision in *Armco, Inc. v. Hardesty* is not controlling. On October 24, 1984, the Supreme Court entered Findings of Fact, Conclusions of Law, and Judgment.

On November 7, 1984, Tyler Pipe timely filed its Notice of Appeal to the Washington Supreme Court, raising as error each of the issues raised and rejected in the Superior Court. On March 6, 1986, the Washington Supreme Court filed its opinion affirming the Superior Court in all material respects.

On April 15, 1986, Tyler Pipe filed its notice of Appeal to the United States Supreme Court. Tyler Pipe filed its Jurisdictional Statement with the Court on May 30, 1986. By order dated October 6, 1986, the Court noted probable jurisdiction in Tyler Pipe's appeal. The Court also ordered this case consolidated for purposes of oral argument with the case of *National Can Corp v. State of Washington Department of Revenue*, No. 85-2006.

B. Statement Of Facts.

Appellant Tyler Pipe is a Delaware corporation with its principal place of business in Tyler, Texas. J.S. A-2; J.A. 16.¹ Tyler

¹J.S. references are citations to pages in the Jurisdictional Statement filed by Tyler Pipe that reproduce the opinions of the lower courts in this case and the relevant statutes: pages A-1 through A-9 contain the opinion of the Washington Supreme Court, pages B-1 through B-15 the opinion and findings of the trial court, pages D-1 through D-16 the opinion of the Washington Supreme Court in the companion case of *National Can Corp. v. State of Washington Department of Revenue*, and pages G-1 through G-5 statutory provisions. J.A. references are citations to pages in the Joint Appendix filed by the parties in this case.

Pipe markets pipe and plumbing products nationwide. *Id.* Tyler Pipe is engaged in two lines of business relevant to this case: the marketing of Utility Division products and the marketing of DWV (drainage, waste and vent) Division products. J.S. A-2; J.A. 22-23.² All of the products marketed by Tyler Pipe in Washington in each line of business are manufactured by Tyler Pipe's wholly-owned subsidiaries in the State of Texas. J.S. A-2; J.A. 18, 23, 63-64.³

The Utility Division provides fittings and other products for utilities or public waterworks companies for the transmission of fresh water, and the DWV Division provides pipes, fittings and other products for installation in buildings to carry out waste water. J.A. 23-24, 30, 64-65, 75-81.⁴

Tyler Pipe was not engaged in business in the State of Washington. Tyler Pipe was not qualified to do business in the State of Washington, did not have an office or other place of business in the State of Washington, did not own any personal property or maintain any inventory in the State of Washington (except through the Wade Division)⁵ and did not have any employees

²"Division" is the word used at Tyler Pipe to describe its different product lines. See J.A. 22-23, 28, 30, 46, 48, 52, 63. "Division" includes the marketing and sales activities of Tyler Pipe and the manufacturing activities of its subsidiaries with respect to a product line. *Id.*

³Tyler Pipe, through its wholly-owned subsidiary Wade, Inc., a Virginia corporation, also engages in a third line of business: the marketing of specification drainage products. J.S. A-2; J.A. 11-13, 23. Wade markets specification drainage products that it has purchased from outside manufacturers, as well as marketing specification drainage products manufactured by Tyler Pipe subsidiaries. J.A. 11. The Wade Division sales are not in issue in this case since the Washington B&O tax was paid on those sales. J.A. 12.

⁴The Wade Division provides drains and other devices which collect waste water within the building for introduction into the waste water system. J.A. 11-12, 23. Wade Division products are distinct from DWV Division products and are separately marketed. J.A. 113.

⁵Mechanical Agents, Inc., an independent sales representative for the Wade Division, did keep an inventory of Wade products on-hand in Seattle. J.S. A-2 through A-3.

located or active in the State of Washington. J.S. A-3; J.A. 30, 37, 40 and 97. Tyler Pipe did not send any personnel into the State of Washington for the purpose of soliciting or accepting orders from customers. J.A. 37. Tyler Pipe did not send any personnel into the State of Washington for the purpose of handling, adapting, designating or repairing any products. J.A. 37, 52. Products sold to Washington customers were shipped directly to the purchasing customer from Tyler, Texas by common carrier, and the purchasing customer was billed by mailed invoice from Tyler, Texas. J.A. 18, 32-33, 64-65. The customer paid Tyler Pipe directly; Tyler Pipe then credited the appropriate division (Utility or DWV). J.A. 18-20. Tyler Pipe did not send any materials or products into the State of Washington except by U.S. Mail or independent common carrier, and solicited sales in the State of Washington only through instrumentalities of interstate commerce, such as displays at national and regional trade shows, advertisements in national and regional trade magazines, and mailings of catalogues and other materials from Tyler, Texas. J.S. B-12, ¶ 15; J.A. 25-28, 29-32, 42-44, 59, 66-67.

Tyler Pipe also solicited sales through the services of Ashe & Jones, Inc., an independent contractor sales representative. J.S. A-2; J.A. 28-29, 94-95.⁶

Ashe & Jones, Inc. is a Washington corporation located in Washington State. J.S. A-2 and A-3. Neither Tyler Pipe nor any of its affiliates has had any ownership interest in Ashe & Jones. J.A. 17-18, 29. Ashe & Jones solicited sales for the Utility Division and for the DWV Division in the states of Washington, Oregon, Idaho, Montana and Alaska, and in Western Canada. J.A. 90, 96, 99, 111, 155. Ashe & Jones held itself out as a manufacturer's representative and solicited sales for other manufacturers, although it did not solicit sales for products that directly

⁶For most of Washington State, the Wade Division utilized a different sales representative from the Utility and DWV Divisions: Mechanical Agents, Inc. J.S. A-2. For a small part of southern Washington, sales for all three Divisions were solicited by Bridgeport Sales, Ltd. of Portland, Oregon. J.S. A-3; J.A. 146.

competed with the Utility Division or DWV Division products. J.A. 94-95, 101, 110, 112.

Ashe & Jones acted independently of Tyler Pipe. J.A. 18, 73, 111-112. Ashe & Jones was not under the supervision or control of Tyler Pipe, and did not receive any marketing, administrative or financial assistance or counselling from Tyler Pipe. *Id.*

The employees of Ashe & Jones were under the sole control of Ashe & Jones. J.A. 18, 111-112. Tyler Pipe did not issue instructions to these employees, did not train or educate them, did not supervise their performance, did not determine their compensation, and did not require them (or Ashe & Jones itself) to spend a minimum amount of time soliciting sales for Tyler Pipe. *Id.*

Ashe & Jones solicited sales of Utility Division products and DWV Division products from plumbing wholesale distributors. J.S. A-2; J.A. 103. The plumbing wholesale distributors, in turn, sold to plumbing contractors and water utilities. J.S. B-8, ¶3; J.A. 64, 75-76, 77, 130. Ashe & Jones also called upon architects, engineers and plumbing contractors to promote the sale of Utility Division and DWV Division products. J.S. B-10; ¶10; J.A. 102-103. Ashe & Jones received a commission on each sale of product in its territory, including the State of Washington, regardless of whether the sale order was delivered to Ashe & Jones for forwarding to Tyler Pipe for acceptance, or whether the order went directly to Tyler Pipe in Texas. J.S. A-3. Ashe & Jones was paid solely on a commission basis and received no other income or financial support from Tyler Pipe. J.A. 18.

Ashe & Jones did not accept any orders on behalf of Tyler Pipe. J.A. 33-36, 150 (¶4), 158. Ashe & Jones did not handle or collect the payments made for Tyler Pipe products. J.S. B-12, ¶61; J.A. 18-19. Ashe & Jones had no authority to bind or obligate Tyler Pipe. J.A. 153 (¶4); and see J.A. 33-36, 149-154, 158-159.

Of the total of approximately 8,336 sales orders received by Tyler Pipe from the State of Washington during the relevant period (excluding Wade), 44.96% were made directly to Tyler Pipe in Texas. J.A. 162. On a divisional basis, 100% of Utility Divi-

sions sales were through direct orders and some DWV Division sales were through direct orders. J.A. 69-72, 162.

In those cases when an order was given initially to Ashe & Jones for forwarding to Tyler Pipe, Ashe & Jones did not process or record the order, but merely relayed it to Tyler Pipe by telephone. J.S. B-11, ¶13; J.A. 19-20, 96. All the paperwork and processing with respect to an order was done by Tyler Pipe in Texas. J.S. B-11, ¶14; J.A. 19-20, 32-33, 36, 64-65. All orders, regardless of how transmitted, were subject to acceptance by Tyler Pipe in Texas. J.A. 33, 35, 36, 153 (¶4), 158. All shipments were direct from Tyler Pipe to the customer. J.S. B-12, ¶15; J.A. 18, 36, 59, 97. Ashe & Jones did not handle Tyler Pipe products. *Id.*

Ashe & Jones did not handle product complaints, receive payments for Tyler Pipe products, assist in collecting delinquent accounts, maintain inventory of Tyler Pipe products, or conduct advertising for Tyler Pipe. J.A. 96-97, 98.⁷

C. The Washington Business and Occupation Tax.

The Washington B&O tax is imposed at the rate of 0.44% upon gross receipts from the sale of products in the state. Wash. Rev. Code §§ 82.04.220 and 82.04.270, J.S. G-2 through G-3 and G-4.⁸ The B&O tax is imposed on the seller, not the buyer, of the items. Wash. Rev. Code § 82.04.500, J.S. G-5. The B&O tax is described in the Code as a tax on the privilege of doing business in the State of Washington. Wash. Rev. Code § 82.04.220, J.S. G-2.⁹

⁷Ashe & Jones on occasion might have been contacted initially by a customer with a complaint or asked by Tyler Pipe if they knew anything about a slow paying customer, but such involvement, if any, was very rare and strictly incidental to Tyler Pipe's handling of these matters from Texas. J.A. 59-60, 62, 88-89, 91-92, 96-97, 104-107, 115-118.

⁸References to "Wash. Rev. Code" or to the "Code" are to the Revised Code of Washington (1974).

⁹Subsequent to the years involved in this case, the State of Washington enacted a surtax that increased the tax rate to 0.485%, although the retailing rate was increased only to 0.475%. See pages E-6 and E-7 of the Jurisdictional Statement in *National Can Corp. v. Department of Revenue*, No. 85-2006, the companion case.

The Washington B&O tax system imposes taxes (i) upon the activity of extraction of raw materials in the state, Wash. Rev. Code § 82.04.230, J.S. G-3, (ii) upon the activity of manufacturing in the state, Wash. Rev. Code § 82.04.240, J.S. G-3, (iii) upon the activity of making wholesale sales in the state, Wash. Rev. Code § 82.04.270, J.S. G-4, and (iv) upon the activity of making retail sales in the state, Wash. Rev. Code § 82.04.250, J.S. G-3. The taxes in issue in this case are wholesaling taxes imposed under Section 82.04.270 of the Code. Section 82.04.440 of the Code provides that persons engaged in two or more taxable activities shall be taxed upon each such activity, *except* that persons who are subject to the wholesaling or the retailing tax shall not also be taxable on their extraction and manufacturing in the state with respect to the same products sold within the state.

It is the exception from taxation provided by Section 82.04.440 of the Code for local sellers that causes the Washington B&O tax system to violate the Constitution. Section 82.04.440 provides an exemption from the extraction tax and the manufacturing tax for local taxpayers who sell their product at wholesale or retail in the state. That benefit is not available to wholesalers (such as Tyler Pipe) or retailers selling products extracted or manufactured out-of-state.

Ashe & Jones was subject to, and paid, a B&O tax of one percent on its commissions from the sale of Utility Division and DWV Division products. Wash. Rev. Code § 82.04.290, J.S. G-4 through G-5; J.A. 98. The plumbing wholesale distributors who purchase from Tyler Pipe are also subject to, and presumably pay, the Washington B&O tax on their resale of the products. Wash. Rev. Code § 82.04.270(1), J.S. G-4.

The Washington State Department of Revenue has assessed \$130,010.56 in taxes and post-assessment interest against Tyler Pipe with respect to the sale of Utility Division products and DWV Division products in Washington for the period January 1, 1976, through September 30, 1980. J.S. A-1; J.A. 12.

Tyler Pipe (and its wholly-owned manufacturing subsidiaries) are subject to, and pay, substantial franchise and *ad valorem* taxes in the State of Texas, both of which taxes are based in part upon the value of the products and the assets utilized in the production and storage of the products sold to Washington customers. J.A. 37-38, 151, 160-161. The State of Texas does not currently impose a net income tax or gross receipts tax.

SUMMARY OF ARGUMENT

Appellant Tyler Pipe Industries, Inc. may not be taxed by Appellee State of Washington Department of Revenue, because the Washington Business and Occupation Tax system violates the Due Process Clause and Commerce Clause of the Constitution.

The Washington B&O tax is unconstitutional as applied to Tyler Pipe, because there is no nexus between Tyler Pipe and the State of Washington. Tyler Pipe is a Delaware corporation with its principal place of business in Tyler, Texas. Tyler Pipe has no office in the State of Washington and has no employees resident or active in the State of Washington. Tyler Pipe conducts no activities in the State of Washington. Tyler Pipe's sole connection with the State of Washington is that it solicits sales from its home office in Tyler, Texas, and through an independent contractor located in Seattle, Washington.

The Washington B&O tax discriminates against interstate commerce, because it provides an exemption to local sellers that is not available to out-of-state sellers. In *Armco, Inc. v. Hardesty*, the Court held that a West Virginia tax, identified both by the State of Washington in its *amicus curiae* brief and by the Court in its opinion as "similar" to the Washington B&O tax, unconstitutionally discriminated against interstate commerce for the same reason.

The Washington Business and Occupation Tax is not fairly apportioned, is not fairly related to the services provided by the state

and lacks a rational relationship to the values of interstate sellers, because it imposes an equal tax burden on interstate sellers with few local connections as it does on local sellers with many local connections.

For any one of the reasons that:

- (i) there is insufficient minimal connection and no substantial nexus between Tyler Pipe and the State of Washington,
- (ii) the Washington B&O tax discriminates against interstate commerce,
- (iii) the Washington B&O tax is not fairly apportioned,
- (iv) the Washington B&O tax is not fairly related to services provided by the state, and
- (v) the Washington B&O tax lacks a rational relationship to intrastate values,

the decision of the Washington Supreme Court should be reversed, and taxes paid by Tyler Pipe refunded.

I. THE CONSTITUTION PROHIBITS THE STATE OF WASHINGTON FROM IMPOSING ITS B&O TAX UPON TYLER PIPE, BECAUSE SOLICITATION OF SALES IN A STATE, WHETHER DIRECTLY OR THROUGH A LOCAL REPRESENTATIVE, IS NOT SUFFICIENT MINIMAL CONNECTION OR SUBSTANTIAL NEXUS TO ALLOW THAT STATE TO TAX THE SELLER.

The Due Process Clause of the Fourteenth Amendment to the United States Constitution (U.S. Constitution, Amendment XIV, Section 1) establishes two requirements that a state must satisfy in order to impose a tax upon the income of an interstate business: (1) there must be a "minimal connection" between the activities of the interstate business and the taxing state, and (2) there must be a "rational relationship" between the income attributed to the

state for tax purposes and the "values" of the business that are connected with the state. *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 436-437 (1980); *Moorman Manufacturing Company v. G.D. Bair*, 437 U.S. 267, 272-273 (1978).

The Commerce Clause of the U.S. Constitution (U.S. Constitution, Article I, Section 8, clause 3) requires that a state may impose a tax upon an enterprise engaged in interstate commerce only if the tax (1) is imposed only upon an activity with a substantial nexus with the taxing state, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services provided by the state. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, *rehearing denied*, 430 U.S. 976 (1977).

Although the requirements that a state tax must satisfy under the Due Process Clause and under the Commerce Clause are phrased differently, the requirements under the two Constitutional Clauses are closely related, and the tests for validity of a state tax are similar. *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois*, 386 U.S. 753, 756 (1967).

The Washington B&O tax, as applied to Tyler Pipe, is unconstitutional under both the Due Process Clause and Commerce Clause, because there is no minimal connection and no nexus between Tyler Pipe and the State of Washington.

The Court has long held that solicitation of sales in a state is not adequate grounds under the Constitution for a state to impose taxes upon an out-of-state seller because such taxes are impediments to interstate commerce. *Robbins v. Shelby County Taxing District*, 120 U.S. 489 (1887). In *Robbins*, the Court held that a Tennessee license tax imposed upon sales solicitors was an unconstitutional impediment, because it burdened the out-of-state sellers who wished to sell in the Tennessee market.

In *Norton Co. v. Department of Revenue of State of Illinois*, 340 U.S. 534 (1951), the Court elaborated on the standards established in *Robbins*. In *Norton*, a Massachusetts corporation contested the imposition of an Illinois gross receipts tax on certain of its Illinois sales. 340 U.S. at 535. The seller's manufacturing site and its management, accounting and credit offices were located in Worcester, Massachusetts, but it also had a branch office and warehouse in Chicago, Illinois from which sales were made. 340 U.S. at 535-536. Norton sold and delivered to Illinois customers (i) from the Illinois local office, (ii) from Worcester through the Illinois office, and (iii) directly from Worcester, bypassing the Illinois office. The seller conceded that the local sales made from its Chicago office and warehouse were subject to the Illinois tax, but asserted that sales made to Illinois customers from its Worcester location directly or through the Illinois office were exempt. *Id.*

The Court held the Worcester sales channeled through the Illinois office were so mingled with the seller's local Chicago business, that the seller was unable to show that the services of its Chicago branch office were not "decisive factors" in seller's establishing and holding the market; consequently, these "mingled" sales were subject to the State of Illinois tax. 340 U.S. at 538.¹⁰

The Court held that sales orders received in Worcester from Illinois customers and filled by shipment directly from Worcester to the Illinois customers were exempt from the gross receipts tax under the Commerce Clause, 340 U.S. at 539, notwithstanding the facts that the seller's local office provided engineering and technical advice to the Illinois customers, the local office provided services to the customers after the sale, the local office replaced

¹⁰For cases setting forth the extensive activity that is necessary to establish sufficient minimal contact and substantial nexus, see *General Motors Corporation v. Washington*, 377 U.S. 436 (1964) (involving a large local staff organization performing extensive sales and other operations in-state), and *Standard Pressed Steel Co. v. Washington Department of Revenue*, 419 U.S. 560 (1975) (involving an employee engaged in engineering and other services full-time in the taxing state).

defective machines and handled complaints, and the local office was the only source of the seller's customer relations in Illinois, 340 U.S. at 541 (Clark, J., dissenting). These "local incidents" to all of seller's sales were insufficient to cause sales direct from Worcester to the Illinois customer to be subject to Illinois taxation.

Tyler Pipe shipped all of its products direct to its customers in Washington by interstate carrier. Further, Tyler Pipe maintained no local office, inventory, or employees in Washington, as did Norton in Illinois. Tyler Pipe did not exercise any control over, nor did it involve itself in the day to day activities of, Ashe & Jones. Tyler Pipe did not provide local engineering and technical advice to Washington customers. It had no local office to provide services to customers after the sale. Tyler Pipe handled complaints from Texas, and replaced defective parts from Texas. Both were rare. There is no evidence that Ashe & Jones provided any of those services.¹¹ Thus, Tyler Pipe performed far fewer activities in Washington with respect to its direct sales than did Norton in Illinois with respect to its direct sales, so that all of Tyler Pipe's sales fall into the third category of nontaxable direct sales established in *Norton*.

Because Tyler Pipe has insufficient local connection with the State of Washington, under the rules established in *Norton*, the State of Washington is constitutionally prohibited from taxing Tyler Pipe on its Washington gross receipts.¹²

¹¹All of the facts relied on by the Supreme Court of Washington to hold that Tyler Pipe had sufficient nexus in Washington were simply the sticks that make up the bundle of sales solicitation. Indeed the Supreme Court of Washington viewed the sales functions of Ashe & Jones as essentially identical to those of factory salesmen. J.S. A-3. That is precisely what *Robbins* and *Norton* say is not sufficient for nexus.

¹²Congress, in enacting the Federal Interstate Income Tax Act, has statutorily provided that similar standards must be applied in determining the extent of a state's power to impose net income taxes. The Act is silent as to gross receipts taxes. See the Appendix to this Brief.

II. THE CONSTITUTION PROHIBITS THE STATE OF WASHINGTON FROM IMPOSING ITS B&O TAX UPON TYLER PIPE, BECAUSE THE WASHINGTON B&O TAX (A) DISCRIMINATES AGAINST INTERSTATE COMMERCE, (B) IS NOT FAIRLY APPORTIONED, (C) IS NOT FAIRLY RELATED TO THE SERVICES PROVIDED BY THE STATE OF WASHINGTON, AND (D) LACKS A RATIONAL RELATIONSHIP BETWEEN THE INCOME OF TYLER PIPE THAT WASHINGTON STATE SEEKS TO TAX AND THE INTRASTATE VALUES OF TYLER PIPE.

The Washington B&O Tax does not comply with the “rational relationship” requirement of the Due Process Clause, nor with the nondiscrimination, fairly apportioned, or fair-relation-to-services requirements of the Commerce Clause. *Mobil Oil Corp. Commissioner of Taxes of Vermont, supra*; *Moorman Manufacturing Company v. G. D. Bair, supra*; *Complete Auto Transit, Inc. v. Brady, supra*.

A. The Washington B&O Tax Discriminates Against Interstate Commerce Because It Imposes A Greater Tax Burden On Interstate Transactions Than It Imposes On The Same Kinds Of Transactions Occurring Entirely Within The State Of Washington.

A state may not impose a tax that discriminates against interstate commerce by providing a direct commercial advantage to a local business. *Armco, Inc. v. Hardesty*, 467 U.S. 638 (1984); *Maryland v. Louisiana*, 451 U.S. 725 (1981).

In *Armco*, the Court held that a gross receipts tax imposed by the State of West Virginia unconstitutionally discriminated against interstate commerce. The seller in *Armco* was an Ohio corporation that sold its products in West Virginia. 467 U.S. at

638. West Virginia imposed a wholesaling tax at the rate of 0.27% on seller’s gross receipts from sales in West Virginia. *Id.* and n. 2. Sellers who manufactured their products in-state were exempt from the wholesaling tax, and paid only an 0.88% manufacturing tax on the value of their manufactured products. 467 U.S. at _____, 104 S. Ct. at 2622 and n. 3 and 5. The seller in *Armco* contested the constitutionality of the West Virginia tax on the ground, *inter alia*, that the tax discriminated against interstate commerce because it exempted local manufacturers from the wholesale tax. 467 U.S. at _____, 104 S. Ct. at 2622.

The Court held that the West Virginia gross receipts tax taxed interstate transactions more heavily than it taxed transactions that occurred entirely within the State, and was unconstitutional, because out-of-state manufacturers were subject to a tax (the 0.27% wholesaling tax) from which in-state manufacturers were exempt. 467 U.S. at _____, 104 S. Ct. at 2622-2623. Although West Virginia manufacturers actually paid a higher rate of tax (the 0.88% manufacturing tax) than did taxpayers selling products in West Virginia that were manufactured elsewhere (the 0.27% wholesaling tax), the Court held that the higher manufacturing tax imposed on in-state sellers did not also include or compensate for a tax on their in-state wholesaling activities, despite the fact that manufacturing frequently entails selling in the state, because the in-state sellers did not pay a reduced tax on their out-of-state sales. 467 U.S. at _____, 104 S. Ct. at 2623.

The Court illustrated the discriminatory effect of the West Virginia gross receipts tax on interstate commerce by analyzing the tax burden on a seller operating in two hypothetical states with the same gross receipts tax system: a wholly in-state seller would pay a maximum tax of 0.88%, whereas an interstate seller would have to pay a total tax of 1.15% (0.88% in one state plus 0.27% in the other). 467 U.S. at _____, 104 S. Ct. at 2623-2624.

The Washington B&O tax is similar to the West Virginia gross receipts tax struck down in *Armco*, because it taxes local sellers

only once when they conduct both manufacturing and wholesaling activities in-state, whereas interstate sellers are taxed at the same rate when they conduct only one activity: wholesaling.¹³ Indeed, in its opinion in *Armco*, the court noted that the two taxes were similar. 467 U.S. at _____, 104 S. Ct. at 2623, citing Justice Goldberg's dissent in *General Motors v. Washington*, *supra*. 377 U.S. at 459.

The Washington B&O tax is more discriminatory than the West Virginia gross receipts, because it taxes extraction of raw materials, as well as manufacturing and wholesaling, all at the same rate of 0.44%, with in-state sellers paying the tax but once. Thus, using the Court's analysis set out in *Armco*, a wholly in-state seller who extracts, manufactures, and sells in Washington would pay a maximum tax of only 0.44%, whereas an interstate seller who manufactures elsewhere would pay a total tax of 0.88% (1.32% if the seller extracted elsewhere as well).

The problem is that Washington provides local manufacturers with an exemption in Section 82.04.440, which is not available to out-of-state sellers. In *Maryland v. Louisiana*, *supra*, the Court has held a taxing system that provided similar benefits for in-state residents violated the Commerce Clause. In *Maryland v. Louisiana*, the Court invalidated a Louisiana first use tax of 7¢ per MCF on gas imported into Louisiana for processing, because tax credits and exclusions were available on much of the gas that remained in Louisiana, which credits and exclusions were not available to gas transported out-of-state. A system of benefits to

¹³Washington taxes the wholesaler and exempts the local manufacturer, whereas West Virginia taxed the local manufacturer but exempted his local sales. Wash. Rev. Code § 82.04.440, J.S. G-5. Also, Washington taxes manufacturing and wholesaling at the same, not differing, rates. Cf. Wash. Rev. Code § 82.04.240, J.S. G-3 to Wash. Rev. Code § 82.04.270, J.S. p. G-4.

¹⁴The State of Washington, on page 1 of its *amicus curiae* brief filed in that case, described the West Virginia tax as "very similar" to the Washington B&O tax.

local sellers, the Court concluded, unquestionably discriminates against interstate commerce in favor of local interests. 451 U.S. at 756.

The Washington Supreme Court, in its opinion upholding the Washington B&O tax, did not deal directly with the Court's decision in *Armco*, preferring instead to see the Court's earlier decision in *General Motors* as dispositive, J.S. D-4 through D-5 and D-12, notwithstanding that *General Motors* did not deal with the issue of discrimination against interstate commerce and notwithstanding that the Court in *Armco*, 467 U.S. at _____, 104 S. Ct. at 2623, cited Justice Goldberg's *General Motors* dissent for the proposition that the Washington B&O tax suffered the same unconstitutional defects as did the West Virginia tax. The Washington Supreme Court also sought to distinguish *Armco* on the grounds that the State of Washington exempts local sellers from the Washington manufacturing tax, whereas the State of West Virginia exempted local sellers from the wholesaling tax, J.S. D-6 through D-8, notwithstanding that the effect of the exemptions in both instances has the same effect of granting local sellers a benefit not available to interstate sellers and notwithstanding that the State of Washington, in taxing all activities at the same rate, actually imposes a greater burden on interstate commerce than did the State of West Virginia.

The Washington B&O tax unconstitutionally discriminates against interstate commerce by giving preferential benefits to in-state manufacturers, and imposes an excessive burden on an interstate seller, such as Tyler Pipe. It is thus internally inconsistent and facially discriminatory and must be struck as violative of the Due Process and Commerce clauses. *Armco v. Hardesty*, *supra*; *Maryland v. Louisiana*, *supra*.

B. The Washington B&O Tax Does Not Fairly Apportion The Tax Burden, Because The Taxable Income and Tax Rate of A Seller Who Manufactures The

Product In-State And Extracts The Raw Materials For Such Product In-State Is Exactly The Same As That Of An Out-Of-State Seller Whose Sole In-State Activity Is Wholesaling.

- C. The Washington B&O Tax Is Not Fairly Related To The Services Provided By The State, Because A Seller Whose Sole Connection With The State Of Washington Is The Wholesaling Of Products Must Pay The Same Amount Of Tax As A Seller Who Extracts Raw Materials For And Manufactures, As Well As Wholesales, The Product In-State, Notwithstanding The Fact That Extraction, Manufacturing And Wholesaling Activities Necessarily Require Greater Utilization Of Public Services Than Does Merely Wholesaling.**
- D. The Income Sought To Be Taxed By the State Of Washington B&O Tax Bears No Rational Relationship To The Values Of Tyler Pipe Connected With The State, Because Tyler Pipe Would Be Taxed At Exactly The Same Rate On Exactly The Same Gross Receipts If It Also Had Extracted Raw Materials And Manufactured Its Product In The State Of Washington.**

An important consideration in determining whether a state may tax an interstate seller is "whether the state has given anything for which it can ask return." *State of Wisconsin v. J.C. Penney*, 311 U.S. 435 (1940).

If Tyler Pipe had engaged in sufficient wholesaling activities in the State of Washington to constitute substantial nexus for constitutional purposes, then Tyler Pipe would have utilized the services and protection of the State to a degree such that the State could ask for return from Tyler Pipe. Even so, Tyler Pipe would

have utilized such services or protections, if any, to only a small fraction of the extent as did Olympic Foundry Company, a competitor of Tyler Pipe that manufactured and sold its products in Washington. J.A. 82, 83. Yet the Washington B&O tax would require Tyler Pipe and Olympic Foundry Company to contribute equally to the support of state services.

Olympic Foundry conducted manufacturing in the State of Washington, but was exempt from the manufacturing tax and subject only to the same wholesaling tax that the State of Washington seeks to impose upon Tyler Pipe's Washington sales. Olympic Foundry thus presumably had a manufacturing facility, inventory, cash, receivables, trucks, employees and other assets located in the State of Washington. Tyler Pipe had none of these in Washington. Indeed, Tyler Pipe used interstate facilities to deliver its products to Washington customers. Tyler Pipe thus had no need for police or fire protection, nor for local utility, zoning, sanitation or other such governmental services. Except for use of the Washington Courts in this case, there is no evidence that Tyler Pipe ever used, or had need for, any State of Washington service with respect to the sales sought to be taxed. A taxing system that forces interstate businesses that use few, if any, state services and a local company that uses many state services to bear an equal share of the tax burden of providing those services is not fairly related to the services provided by the state.

With respect to sales made by the Utility Division and the DWV Division to Washington customers, Tyler Pipe's values are located in Texas where its facilities and employees are located.¹⁵ Even if, with regard to such sales, Tyler Pipe had conducted substantial activities in the State of Washington and therefore had substantial values in the State of Washington, most (or at least much) of Tyler Pipe's values would still be located in Texas.

¹⁵The values of Ashe & Jones in the State of Washington were taxed by the state—see above, p. 8.

The State of Washington seeks, however, to impose its B&O tax on Tyler Pipe at the same tax rate as if all of Tyler Pipe's activities and values with respect to its Washington sales were located in the State of Washington—at the same tax rate as if Tyler Pipe were also extracting raw materials for and manufacturing its product in the State of Washington. The measure of the tax is thus not reasonably related to Tyler Pipe's contact with the State of Washington. *Commonwealth Edison Company v. Montana*, 453 U.S. 609, 610 (1981).

CONCLUSION

The decision of the Washington Supreme Court was in error because (i) Appellant Tyler Pipe has insufficient minimal connection and no substantial nexus with the State of Washington, (ii) the Washington B&O tax discriminates against interstate commerce, (iii) the Washington B&O tax is not fairly apportioned, (iv) the Washington B&O tax is not fairly related to the services provided by the State, and (v) the Washington B&O tax is not rationally related to the values of Appellant in the State. For all or any one of these reasons, the Washington B&O tax violates both the Commerce Clause and Due Process Clause, and the Court should reverse the decision of the Supreme Court of Washington.

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APPENDIX

The Federal Interstate Tax Act Provides That a Seller May Solicit Sales in a State Directly or Through an Independent Contractor Without Being Subject to Income Taxation in That State.

- (1) The Federal Interstate Income Tax Act prohibits a state from taxing an enterprise whose sole activity in the state is the solicitation of sales, whether directly or through an independent contractor sales representative with an in-state office.

The Federal Interstate Income Tax Act, 15 U.S.C. §§381 to 384, J.S. G-1 through G-2, provides that no state may impose a net income tax upon a seller if the only business activities of the seller in the state are the solicitation of orders for sales of personal property. 15 U.S.C. §381(a)(1), J.S. G-1. The sales orders must be sent outside the state for acceptance and must be filled by shipment from outside the state. 15 U.S.C. §381(a)(1), J.S. G-1. The provisions of the Act do not apply, however, to sellers incorporated or domiciled in the taxing state. 15 U.S.C. §381(b), J.S. G-2.

The out-of-state seller may also engage independent contractors to solicit sales in the state without incurring state taxation. 15 U.S.C. §381(c), J.S. G-2. An independent contractor is defined for purposes of the statute as "a commission agent, broker, or other independent contractor" who solicits sales of personal property for more than one principal and who holds himself out as such. 15 U.S.C. §381(d)(1), J.S. G-2. The maintenance by the seller's independent contractors of an office in the taxing state is expressly permitted without causing the seller to be subject to state taxes. 15 U.S.C. §381(c), Jur. St. at G-2.¹

The Federal Interstate Income Tax Act does not draw the line between taxable and nontaxable sellers, but establishes a minimum level of contact with a state that will be clearly beyond the

¹The original proposed version of the Act provided that the seller himself may maintain an in-state sales office, but this provision was apparently dropped. See, S. Rep. No. 658, 86th Cong., 1st Sess. reprinted in 1959 U.S. Code Cong. & Ad. News at 2548, 2552 and 2553-54.

reach of the states' taxing power. S. Rep. No. 658, 86th Cong., 1st Sess. *reprinted in* 1959 U.S. Code Cong. & Ad. News, at 2554; Conf. Rep. No. 1103, 86th Cong., 1st Sess. *reprinted in* 1959 U.S. Code Cong. & Ad. News, at p. 2560. If an out-of-state seller's activities go beyond the solicitation of sales, then the seller may not utilize the safe harbor of the Act to avoid state taxation, but there still may be insufficient minimal connections and lack of substantial nexus under the Constitution with the taxing state.

- (2) Because the Washington B&O tax is a *gross* receipts tax, and not just a *net* income tax, the Washington B&O tax should be reviewed according to standards even stricter than those of the Federal Interstate Income Tax Act, in accordance with the Court's past decisions and Congressional policy.

A gross receipts or gross income tax should be required to pass Constitutional muster under at least as strict a standard as that applied to net income taxes because such taxes are even more burdensome on interstate commerce than net income taxes. The Court has often pointed out that a tax on gross receipts inherently imposes a greater burden on interstate commerce than a net income tax because it creates a greater danger of multiple taxation and cumulative burdens on interstate commerce, *National Geographic Society v. Calif. Board of Equalization*, 430 U.S. 551, 557 (1977); *General Motors Corp. v. Washington*, 377 U.S. at 440, and because a gross receipts tax is imposed on the seller even if the seller realizes little or no profits and could turn a marginally profitable business into a losing venture, *Moorman Manufacturing Co. v. Barr*, 437 U.S. at 280.² Logically, therefore, if the standards to be applied to determine the sufficient minimal con-

²In *Moorman*, the Court upheld imposition of a net income tax with a one factor (sales) apportionment, where a gross receipts tax on those sales would have been valid under the Constitution. 437 U.S. at 280. The seller in *Moorman* had 500 salesmen and six warehouses in the taxing state. 437 U.S. at 269.

nexion and substantial nexus required to justify a gross receipts or gross income tax are to differ from those applied to justify net income taxes, those standards should be much more restrictive of the states' taxing powers over interstate commerce.

Congress had intended, moreover, that persons engaging in interstate commerce who could not be subject to a state's net income tax under the Federal Income Tax Act, would also not be subject to the state's gross receipts taxes:

It was the purpose of both Houses to specifically exempt from state taxation, income derived from interstate commerce where the only business activity within the State by the out-of-state company was solicitation.

Conf. Rep. No. 1103, *supra*., at 2560-61; and see, *Heublein, Inc. v. South Carolina Tax Comm.*, 409 U.S. 275, 280 (1972).

The Federal Interstate Income Tax Act was passed by Congress in 1959 in response to the Court's decision in *Northwestern States Portland Cement v. State of Minnesota*, 358 U.S. 450 (1959), which upheld the validity of a state net income tax imposed on an out-of-state seller.³ Senate Report No. 658, *supra*., at p. 2549. At the time the statute was passed, gross receipts taxes imposed on out-of-state sellers were already unconstitutional "privilege taxes" under *Freeman v. Hewit*, 329 U.S. 249 (1946) and *Spector Motor Service v. O'Connor*, 340 U.S. 602 (1951). 358 U.S. at 458. The more flexible rule, which allows a state to tax out-of-state sellers if there is sufficient nexus between the state and the seller, was not applied to gross receipts taxes until *Complete Auto Transit, Inc. v. Brady*, *supra*, eighteen years after the Federal Interstate Income Tax Act had been passed. Congress thus did not specifically include gross receipts taxes in the cover-

³One seller in *Northwestern States* had a furnished sales office, two cars and several employees in the state, 358 U.S. at 454; the other seller also had a sales office and maintained an inventory in the state, 358 U.S. at 455. The Act, as passed, would not have saved either seller from state taxation. See Note 1, above.

age of the Federal Interstate Income Tax Act because states were already prohibited under the *Freeman* and *Spector Motors* cases from imposing such taxes on out-of-state sellers.

The Congressional intent to "exempt from State taxation income derived from interstate commerce . . . where the only business activity within the state . . . was solicitation" should therefore be construed in the context in which it was passed as an expression of Congressional policy that applies to gross receipts taxes as well as to net income taxes.

In light of the expressed concern of Congress that state net income taxes may impose unwarranted burdens on interstate commerce, the standards Congress established for net income taxes are worthy of consideration in determining what should constitute the minimum connection and substantial nexus required for imposition of the even more burdensome gross income taxes, particularly in light of the judicial history of gross receipts taxes.

- (3) Because Tyler Pipe's sole connection with the State of Washington is the utilization of an independent contractor to solicit sales in Washington, the State of Washington would be prohibited from imposing an income tax upon Tyler Pipe under the Federal Interstate Income Tax Act.

If the Washington B&O tax were a net income tax, there would be no question but that the State of Washington could not tax Tyler Pipe under the Federal Interstate Income Tax Act. The orders for Utility Division and DWV Division products are sent to Tyler Pipe in Texas, acceptance of such orders is made by Tyler Pipe in Texas, and Tyler Pipe ships the products to the customers from Tyler, Texas. Tyler Pipe is not incorporated or domiciled in the State of Washington, and is not even qualified to do business in Washington. Tyler Pipe's sales representative in Washington

State, Ashe & Jones, is an independent contractor under the Act because it is compensated on a commission basis, solicits sales for other sellers and holds itself out as a commissioned manufacturer's representative. The only activities of Tyler Pipe and its independent contractor sales representative in the State of Washington are the solicitation of sales, which are specifically inadequate grounds under the Act for state taxation.

CERTIFICATE OF SERVICE

It is hereby certified that service of the foregoing Brief of Appellant was made this day of November, 1986, upon all parties required to be served by depositing three copies thereof in the United States Mail, first class postage prepaid, addressed:

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**SUPREME COURT
OF THE
UNITED STATES**

OCTOBER TERM, 1986

TYLER PIPE INDUSTRIES, INC.,

Appellant,

v.

**STATE OF WASHINGTON
DEPARTMENT OF REVENUE,**

Appellee.

NATIONAL CAN CORPORATION, et. al.,

Appellants,

v.

**STATE OF WASHINGTON
DEPARTMENT OF REVENUE,**

Appellee.

**ON APPEAL FROM THE
SUPREME COURT OF WASHINGTON**

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QUESTIONS PRESENTED

Washington imposes a tax on the business activities of selling and manufacturing, within the state, measured by the gross proceeds derived from those activities. The tax applies at essentially the same rate and measure to (1) the in-state manufacture of goods sold elsewhere; (2) the in-state sale of goods manufactured elsewhere; and (3) the in-state sale of goods both manufactured and sold in state.

This case presents the following questions regarding that tax:

(1) May Washington impose its selling tax on goods manufactured elsewhere and sold in Washington if it also imposes its selling tax, at the same rate and measure, on goods both manufactured and sold in Washington?

(2) May Washington impose its manufacturing tax on goods manufactured in Washington and sold elsewhere if it also imposes its selling tax, at the same rate and measure as the manufacturing tax, on goods both manufactured and sold in Washington?

(3) May Washington impose its selling tax on goods manufactured elsewhere and sold in Washington and its manufacturing tax on goods manufactured in Washington and sold elsewhere, measured by the value attributable to those activities in the state, without the requirement of further apportionment?

(4) Do the selling activities of the in-state representatives of Tyler Pipe Industries, Inc. provide sufficient nexus for the imposition of Washington's gross receipts tax on its selling in the state? If so, is such nexus avoided when the activities are performed by independent contractors rather than employees?

(5) Is a tax imposed by Washington on the selling activities of a business in the state, measured by the gross proceeds from Washington sales of its products, fairly related to the services provided by the state?

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**SUPREME COURT
OF THE
UNITED STATES**

OCTOBER TERM, 1986

TYLER PIPE INDUSTRIES, INC.,

Appellant,

v.

STATE OF WASHINGTON
DEPARTMENT OF REVENUE,

Appellee.

NATIONAL CAN CORPORATION, et. al.,

Appellants,

v.

STATE OF WASHINGTON
DEPARTMENT OF REVENUE,

Appellee.

**ON APPEAL FROM THE
SUPREME COURT OF WASHINGTON**

BRIEF FOR APPELLEE

STATEMENT OF THE CASE

Tyler Pipe Industries, Inc. (TPI) and National Can Corporation (NCC) challenge the validity of Washington's business and occupation (B&O) taxes paid on their business activities in Washington. We begin by briefly describing the tax and the activities of TPI and NCC (The Taxpayers), respectively.

I. WASHINGTON'S B&O TAX.

Washington's B&O tax system is broad in its sweep. The keystone for that system is Wash. Rev. Code § 82.04.220,

which levies a tax "for the act or privilege of engaging in business activities". The statutory definitions of the terms used in this provision are equally broad. Thus, Wash. Rev. Code § 82.04.150 defines "engaging in business" to include "commencing, conducting, or continuing in business and also the exercise of corporate or franchise powers". "Business" is itself broadly defined in Wash. Rev. Code § 82.04.140 to include "all activities engaged in with the object of gain, benefit, or advantage". The Washington Supreme Court has accurately summarized the effect of these provisions as imposing B&O tax "upon virtually all business activities carried on within the state." *Time Oil Co. v. State*, 79 Wn.2d 143, 146, 483 P.2d 628 (1971).

A. The Selling and Manufacturing Taxes Apply, at the Same Rate and Measure, to Separate Activities That Are Functionally Related.

The Taxpayers challenge taxes imposed on the activities of selling and manufacturing. The selling tax is imposed upon every person who makes sales in Washington, either wholesale or retail. Wash. Rev. Code §§ 82.04.270 and 82.04.250. NCC J.S. E-2, -4. The manufacturing tax is imposed upon every person engaged in business as a manufacturer in Washington. Wash. Rev. Code § 82.04.240. NCC J.S. E-2.

Although selling and manufacturing are separate categories of activities, they are functionally related. One who manufactures products either sells them or puts them to use. If they are put to use, the user avoids buying them from someone else. This functional relationship is explicitly recognized in the law. A "manufacturer" is defined as one who makes products "for sale or for commercial or industrial use". Wash. Rev. Code §§ 82.04.110 and 82.04.120.

In addition to the functional relationship between selling and manufacturing, the taxes on these activities have two common characteristics. First, the selling and manufacturing taxes have the same basic rate — .0044.¹ Wash. Rev. Code §§ 82.04.240, 82.04.250 and 82.04.270. Second, the selling and

¹ During part of the period for which NCC (but not TPI) seeks a refund, a surtax was imposed in addition to the selling and manufacturing taxes. Effective July 1, 1983 a combination of the basic rate (.0044) and the surtax for wholesaling and manufacturing taxes was .00484. The combination for retailing tax was .00471. Wash. Rev. Code §§ 82.02.030, 82.04.2901 and 82.04.2904. NCC J.S. E-1, -6.

manufacturing taxes have the same measure, that is, the same base to which the rate is applied. The measure of the selling tax is the "gross proceeds of sales" in Washington. Wash. Rev. Code §§ 82.04.250 and 82.04.270. The measure of the manufacturing tax is the "value of the products" manufactured, which is determined by the "gross proceeds derived from the sale thereof". Wash. Rev. Code §§ 82.04.240 and 82.04.450. NCC J.S. E-8.

B. The Multiple Activities Exemption Operates so That Products Manufactured or Sold in Washington Bear One B&O Tax, Manufacturing or Selling.

Although selling and manufacturing are separate categories of activities, Washington does not impose both a selling and manufacturing tax with regard to the same product. This is because of the operation of the so-called multiple activities exemption, Wash. Rev. Code § 82.04.440. NCC J.S. E-8. Under this statute "persons taxable under [retailing] or [wholesaling] shall not be taxable under [manufacturing] with respect to * * * manufacturing of the products so sold".

The key is that the multiple activities exemption only applies to products actually subject to Washington's selling tax. For example, if a business manufactures and sells a chair in Washington for \$1,000 it is subject to selling tax of \$4.40 (\$1,000 x .0044). The multiple activities exemption exempts the business from manufacturing tax for making that chair. However, the exemption from manufacturing tax obtained by paying selling tax on one product, such as a chair, applies to no other product manufactured by the business, such as a table.

To carry the example further, if a business pays no selling tax with regard to a table made in Washington, it is liable for manufacturing tax. There are two reasons why selling tax might not be paid. First, the table might be used instead of sold. Second, the table might be sold in another state. The manufacturing tax thus due is imposed at the same rate and on the same measure as the selling tax. Accordingly, if the value of the table is \$1,000, the manufacturing tax due for making the table is \$4.40.

The end result of these statutes is that all products sold

or manufactured in Washington are subject to one B&O tax, either selling or manufacturing. The amount of that selling and manufacturing tax will be the same because the measure of the two taxes and the rate of the two taxes are the same.

II. TPI'S ACTIVITIES IN WASHINGTON.

TPI seeks a refund of selling taxes paid on its wholesale sales delivered to Washington customers for a 57-month period, January 1, 1976 through September 30, 1980, in the amount of \$130,010. TPI J.S. B-8 FF 1.² The sales were of pipe and other plumbing products. These were manufactured outside of Washington by one or more of TPI's subsidiary corporations and then initially sold to TPI; TPI itself does no manufacturing. TPI Br. 4; TPI J.S. B-8 FF 2; J.A. 4, 17, 23, 36, 48, 135.

TPI receives from the State of Washington police and fire protections, the availability of the courts, and "numerous other advantages of a civilized society". TPI J.S. B-12 FF 18.

On the facts in the record, including detailed findings of fact, the Washington Supreme Court found a sufficient tax nexus between TPI's activities and Washington. TPI J.S. A-1-9. TPI, however, seeks to retry the facts by offering this Court a highly selective summary, TPI Br. 3-7, which does not truly reflect the record. Accordingly, we will describe TPI's marketing operation in Washington and three categories of functions performed by its Washington representatives.

A. TPI Markets Its Products through Sales Representatives, Either Employees or Independent Contractors, Both of Whom Perform Identical Functions.

TPI's marketing division consists of two sales departments, DWV (drainage, waste, vent) and Utility. TPI J.S. B-8 FF 2; J.A. 128-29. These departments do their local marketing across the country through sales representatives, who are either employees or, as in Washington, independent contractors. TPI J.S. B-9 FF 6; J.A. 122-23, 126-27.

²References to the TPI record in this section are as follows: FF refers to a Finding of Fact; RP and Ex. refer respectively to the Verbatim Report of Proceedings and individual Exhibits from the trial, in No. 85-1963.

There are no significant differences in authority and functions between the employee and contractor representatives. TPI J.S. B-11 FF 12; J.A. 61-62, 87, 124, 126-27. Both types are directed, supervised, and instructed by TPI personnel. TPI J.S. B-9 FF 5; J.A. 131-32, 134. Both the employees and contractors are paid on commission; the employees, however, receive insurance benefits and the contractors receive a little higher commission rate. J.A. 122-27. The contractor representatives are TPI's agents. J.A. 110. They do not handle any competing product lines, although they do also represent other non-competing companies. J.A. 95, 100, 152. When TPI asks them to do something, they do it. J.A. 90, 107.

For most of Washington, TPI utilizes two independent contractors. Representative Ashe & Jones performs virtually all of the sales functions in its territory for all TPI products, except those of TPI subsidiary Wade, Inc.³ TPI J.S. B-8-9 FF 3, 6; J.A. 48-49, 137. Ashe & Jones employs "three and a half" sales people. J.A. 102. Its territory is principally the State of Washington, with half of its customers being located in Western Washington. J.A. 29, 107. During the relevant 57-month period, Ashe & Jones was involved in \$22,345,110 worth of TPI Washington sales. J.A. 139. Ashe & Jones receives a commission for every TPI sale made in its territory, even if the customer forwards its order directly to TPI rather than through the representative. TPI J.S. B-9 FF 6; J.A. 97, 139. Ashe & Jones represents both the DWV and Utility departments, and its commissions are calculated on the basis of both DWV and Utility sales. TPI J.S. B-8 FF 3; J.A. 110; RP 245. Ashe & Jones pays B&O tax measured only by the sales commissions it receives. J.A. 98-99.

During the relevant 57-month period, TPI sent five of its officers or employees into Washington (one of them six times), to provide liaison with its sales representatives, for routine goodwill promotion, to attend a regional trade show, and to

³The second contractor representative, Mechanical Agents, Inc., represents Wade, Inc., a wholly-owned subsidiary of TPI which markets specification drainage products. Mechanical Agents maintains an inventory of Wade products (owned by TPI/Wade) in its Seattle warehouse. TPI J.S. B-9 FF 4. Mechanical Agents employs four sales people who engage in numerous Washington activities on Wade's behalf. J.A. 113-14; RP 340. TPI is no longer contesting the taxes measured by Wade sales. TPI J.S. B-8 FF 1.

provide customer service. Ex. 14, RP 2, 85. TPI provides other assistance to its representatives also, such as in handling customer problems, calling on contractors and engineers, and closing orders. TPI J.S. B-9 FF 5; J.A. 131, 133-34.

B. TPI's Sales Representatives Regularly Provide Virtually All of TPI's Information about the Washington Market.

Washington sales representatives provide virtually all of the Washington market information obtained by TPI. This information, provided on a regular, timely basis,⁴ is necessary to keep TPI competitive in the marketplace. TPI J.S. B-9-10 FF 8; J.A. 50, 124-25, 143-44. It helps TPI to complete its national picture. J.A. 67.

Ashe & Jones provides both specific and general market information. Specific information is provided about competitors' products, pricing, and activities. TPI J.S. B-10 FF 8; J.A. 49, 68, 88, 101, 104; cf. Ex. 50, RP 299, 300. Ashe & Jones reports on existing and potential new customers, customer financial reliability, and any special financial or other risks involved in potential sales. TPI J.S. B-10 FF 8; J.A. 84-86, 120-21, 148, 153. Information is also provided to keep TPI abreast of competitive and market conditions and business activity in general. This includes vital feedback about market trends, construction activity, "bellwether" contractors, prospective orders, product performance, and personnel and ownership changes in the trade. TPI J.S. B-10 FF 8; J.A. 49, 50-51, 55, 68, 95, 99, 102.

C. TPI's Sales Representatives Solicit and Process Orders from Washington Customers.

TPI's sales representatives regularly call on the trade for TPI to promote sales and solicit orders from wholesalers. TPI J.S. B-10 FF 9; J.A. 55, 103, 146. They also regularly receive specific orders and transmit them to TPI. TPI J.S. B-10 FF 9;

⁴Ashe & Jones personnel communicate by telephone with TPI personnel about a dozen times a week, including communications "quite often" (about 3 to 5 times a week) with the Utility department in particular. RP 255-56, 276-80. These communications are used to convey to both the DWV and Utility departments the described market information obtained from calls on the trade and to transmit and coordinate specific orders. J.A. 55, 68, 99-101, 107.

J.A. 96, 162. Ashe & Jones talks to TPI's DWV order desk approximately 2 or 3 times a week to place orders, and to its Utility order desk about once every other week. RP 275-76, 278.⁵

During the relevant period, Ashe & Jones transmitted to TPI 55.04% of TPI's total orders from Washington customers (excluding Wade). Stated another way, Ashe & Jones transmitted no Utility orders but 98% of the remaining non-Wade orders. J.A. 162.⁶ TPI did not reject any order transmitted by a Washington sales representative. TPI J.S. B-11 FF 13; J.A. 150.

D. TPI's Sales Representatives Develop and Maintain the Washington Market for TPI Products.

Ashe & Jones personnel generate future orders by spending a significant part of their time making "secondary calls" to persuade Washington engineers, architects, and contractors (the customers of TPI's customers) to specify and use both DWV and Utility products in their projects. TPI J.S. B-10 FF 10; J.A. 55, 102-03. Sometimes these calls are in response to inquiries triggered by advertising. J.A. 58. The representative provides price quotations of TPI products for specific construction projects. TPI J.S. B-10 FF 10; J.A. 47-48, 132, 146. These secondary calls help to maintain TPI's relationships with the engineers and contractors. J.A. 109.

After an order has been placed, the sales representative has a follow-up role. If a Washington customer has a problem with shortages, non-conforming goods, or the amount of an invoice, that customer generally contacts TPI's local sales representative, who will participate in investigating and handling any adjustment. TPI J.S. B-10 FF 10; J.A. 59, 106. These contacts, about both DWV and Utility products, are made with Ashe & Jones about 10 to 12 times a year. J.A. 88-89, 92, 104-06.

⁵Although Ashe & Jones does not usually transmit Utility orders, it calls the Utility order desk for the purpose of coordinating Utility and DWV shipments. RP 278-79.

⁶Transmitted non-Utility non-Wade orders (4,588) divided by total non-Utility non-Wade orders (4,683) equals .979. J.A. 162.

The sales representative performs still other important services for TPI. TPI requires the sales representative to serve as the first line evaluator of a potential new customer's financial responsibility. J.A. 153 ¶ 4. The representative may make inquiries for TPI regarding late payments. TPI J.S. B-10-11 FF 10; J.A. 115, 118-19. A representative also makes other communications on TPI's behalf, such as providing counteracting sales information about specific competing products and calling on plumbing inspectors and plumbing code authorities. TPI J.S. B-10 FF 10; J.A. 55; RP 301-02; Ex. 50, RP 299, 300.

TPI's sales representatives have long-established and valuable relationships with its customers and with engineers, architects, and contractors in the trade. TPI J.S. B-9 FF 7; J.A. 103. Through their sales contacts, the representatives "keep the door open for further transactions", reminding wholesalers and others that TPI is actively soliciting their DWV and Utility business. J.A. 55, 87. The representatives maintain and improve TPI's name recognition, market share, goodwill, and customer relations. TPI J.S. B-9 FF 7; J.A. 58, 110, 149. The sales representatives are involved in *all* TPI Washington sales transactions, either actively or at least in the sense of being present, aware of the transactions, and available to assist if necessary. The sales representatives afford to TPI's customers the "presence" of TPI, because they are "there to be of benefit to the wholesaler at whatever point possible." TPI J.S. B-11 FF 11; J.A. 56.

III. NCC'S ACTIVITIES IN WASHINGTON.

NCC sells packaging products in Washington and throughout the world. These products are manufactured in twenty-two states including Washington. J.A. 178 ¶¶ 2, 3. In Washington NCC employs approximately 240 people with a payroll in 1983 of approximately \$7.6 million. J.A. 179 ¶ 6. These employees are involved in the manufacture of products at the two plants located in this state. This number also includes NCC's Washington sales office. J.A. 179-80 ¶¶ 6-8.

During the period January 1, 1980 through December 31, 1984 NCC was subject to taxes on its selling and manufacturing activities in Washington. NCC paid selling tax (wholesaling) of \$606,863 on the sales of products in Washington that

were manufactured elsewhere. J.A. 180 ¶ 9. This selling tax was measured by the gross proceeds of sales which ranged from \$19.9 million to \$32 million between 1981 and 1984. J.A. 180 ¶ 9. In contrast, NCC's worldwide sales in 1983 were approximately \$1.552 billion. J.A. 181 ¶ 13.

NCC also paid manufacturing tax of \$372,843 on products manufactured in Washington and sold elsewhere. J.A. 180 ¶ 10. This manufacturing tax was measured by the value of the products, as determined by their sales price, which ranged from \$11.3 million to \$18.7 million between 1981 and 1984. J.A. 180 ¶ 10. NCC challenges the imposition of both the selling and manufacturing taxes.

SUMMARY OF ARGUMENT

1. The one common, and in our view most important, issue is The Taxpayers' claim that Washington's B&O tax discriminates against their selling and manufacturing activities conducted within Washington. This appeal calls upon the Court once again to test such discrimination claims under the Commerce Clause parameters which govern interstate businesses and the states.

In early Commerce Clause cases, the Court observed that a case-by-case approach provided "little in the way of precise guides to the States in the exercise of their indispensable power of taxation." See e.g., *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 457 (1959). Recently, however, the Court has identified a clear, workable "bright line" test which draws the line between (1) a system which discriminates against interstate commerce, and (2) a system which fairly encourages in-state business.

In *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 329, 336-37 (1977), the Court clearly set out those parameters when it contrasted tax systems which "encourage the growth and development of intrastate commerce and industry" and "compete with other states for a share of interstate commerce" with those which discriminate "by providing a direct commercial advantage to local business."

Under the test a state tax system, viewed as a whole, may neither erect barriers to the flow of goods and services into a state, nor provide inducements to a taxpayer, in the form of

reduced tax burdens, to increase its business activity within a state. These two effects are simply different sides of the same coin. If, by avoiding these consequences, the system allows to the taxpayer tax neutral decision-making, then that system is not discriminatory.

Armco, Inc. v. Hardesty, 467 U.S. 638 (1984) is in harmony with this test. Washington's challenged tax system meets the test for nondiscrimination and is thus distinguishable from the West Virginia statute invalidated in *Armco*. Nevertheless, The Taxpayers seize upon unessential language in *Armco*, dealing with concepts of compensating taxes and the internal consistency of tax systems, to argue for a different result. The Taxpayers fail, however, to deal with this Court's articulated test for discrimination. The Taxpayers would jettison the bright line test, but offer no substitution that accommodates the interests of taxing states and interstate businesses consistent with the Court's prior rulings.

2. Initially, the source and scope of the discrimination claim must be examined. Washington's tax applies to (1) businesses that manufacture within the state, (2) businesses that sell within the state, and (3) businesses that do both. The Taxpayers' discrimination claim addresses the treatment given to those businesses that conduct *both* activities within the state *with respect to the same products*. In Washington, such businesses are involved in two different sorts of business activities, but are taxed only once on the totality of in-state business activity. The Taxpayers claim that Washington discriminated when it elected to impose only one tax because two functional activities are involved in that totality. Their claim has two aspects.

The Taxpayers, representing both Washington manufacturers selling outside the state and out-of-state manufacturers selling within the state (who both pay only one Washington tax), argue that Washington's law discriminates. They argue *Armco* requires internal consistency and if other states had Washington's system, taxes would be doubled up on the interstate level but not on the intrastate level. They argue this requires striking down *both* the manufacturing tax and the selling tax.

The Taxpayers also argue Washington's tax discriminates because businesses which manufacture in state but sell out of

state pay under a manufacturing classification and those businesses which both manufacture and sell in state pay only under a selling classification pursuant to Wash. Rev. Code § 82.04.440, the multiple activities exemption. The measure and rate of the tax is identical under both classifications. The Taxpayers argue this tax, paid under the selling classification, is irrelevant because taxes on selling and manufacturing can never be complementary.

3. First, we apply the bright line test to each tax classification. Washington's selling tax, challenged in both cases, meets the bright line test because *all* sellers pay that tax. The same rate and the same base always apply. The tax erects no barrier to goods coming into the state and provides no inducement to taxpayers, in the form of a reduced tax burden, to move manufacturing operations into the state. *Armco* is not applicable because it involved a selling tax which did not apply to all sellers, but instead completely excluded in-state manufacturers.

A taxpayer subject to Washington's selling tax is never subject to Washington's manufacturing tax for the goods it sells in Washington, whether those goods be manufactured in Washington or elsewhere. Where the taxpayer locates its manufacturing operations has absolutely no effect on that taxpayer's tax. Such tax neutral decision-making is exactly the type of fair encouragement which this Court has approved.

Additionally, TPI's challenge to the selling tax is without merit because TPI is solely a seller, not a manufacturer. It buys the products it sells from separate subsidiaries.

4. The manufacturing tax, which is involved only in NCC, is not discriminatory; for taken together with the selling tax, it too allows for tax neutral decision-making. The two taxes combined neither erect a barrier to goods or services flowing into the state nor provide the prohibited inducement to the taxpayer to increase business operations within the state. For this reason, the manufacturing tax should be considered a permissible compensating tax.

The Court's prior compensating tax decisions, including *Maryland v. Louisiana*, 451 U.S. 725 (1981) on which The Taxpayers also rely, are consistent with the test we here invoke. Under those cases, the bright line (*i.e.*, "tax neutral decision-making") test is the test actually applied to determine

whether a tax is a compensating tax. Nor is *Armco* to the contrary. *Armco* did not hold, as NCC argues, that taxes on manufacturing and selling can never be compensatory to each other. *Armco* simply held that West Virginia, by providing different rates and measures for the two taxes, did not actually treat them as compensatory. Because the measure for the manufacturing tax could be reduced well below that for the selling tax, the West Virginia system shared the same vice as the tax systems found defective in *Boston Stock Exchange* and *Maryland v. Louisiana*. Further, NCC's overly broad reading of *Armco* is contrary to *Hinson v. Lott*, 8 Wall. 148 (1869) where a manufacturing tax was treated as compensatory to a related selling tax. To adopt NCC's reading of *Armco* results in a conceptual quagmire. Instead of the workable test which this Court has previously developed and utilized, and upon which we rely, NCC proposes a metaphysical examination into whether the events being taxed are "substantially equivalent". NCC offers no guides as to what constitutes either equivalency or substantiality under that kind of examination.

5. NCC's argument that even if the manufacturing tax is considered a compensating tax, the principle of internal consistency in *Armco* requires invalidation, is wrong. It reads *Armco* too broadly, is not supported by *Armco*'s actual language, and would render invalid compensating taxes which have previously been held valid in *Hinson* and *Southern Pacific Co. v. Gallagher*, 306 U.S. 161 (1939). That reading would invalidate as well Washington's selling tax, which presents no compensating tax issue.

The internal consistency issue is: if State A refuses to double tax the same item — for example, by foregoing the use tax if it has imposed a sales tax — must it extend like treatment to State B's sales tax through a credit or other offset? The Court has consistently refused to resolve that question. See *Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937); *Southern Pacific*; and *Williams v. Vermont*, 472 U.S. ___, 105 S.Ct. 2465 (1985), a post-*Armco* case. This demonstrates that the Court's discussion in *Armco* was not intended to resolve it.

NCC's argument in support of its claim of discrimination is fundamentally flawed because, if accepted, it would result in

preferential treatment for NCC over local taxpayers. NCC seeks relief from the Washington tax on manufacturing even if it pays no tax at all on its selling activities in another state. This is hardly a claim for equal treatment with local taxpayers, who must always pay a tax.

6. Washington's tax satisfies the apportionment prong of the Commerce Clause test because it has long been settled that a state may impose (1) a tax on in-state manufacturing, measured by the gross sales of the goods so manufactured; and (2) a tax on in-state selling activities, measured by the gross sales to in-state customers generated by those activities. Further, as *Armco* confirmed, the state of manufacture and the state of sale may each impose its tax, each using the same gross proceeds as the measure; one state need not defer to the other. For both types of taxes, the requirement of fair apportionment means only that the gross proceeds used as the measure must be fairly related to the in-state activities. Contrary to the claims of The Taxpayers and amicus Amcord, no further diminution of the measure of the tax is required.

7. TPI clearly satisfies the nexus requirement, as found by the trial court, because TPI's sales representative in Washington, Ashe & Jones, engaged in substantial activities including gathering market information, solicitation, and market maintenance. The fact that this representative is not formally an employee, but an independent contractor, makes no difference under the rationale of *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960). This contractor representative functions and is compensated in essentially the same manner as TPI's employee representatives elsewhere. TPI's further claim that the tax is not fairly related to benefits provided by the state presents no issue separate from the nexus claim, and is essentially groundless.

8. Should the Court reverse the decisions below on either the discrimination issue or the apportionment issue, such a result would constitute a significant change from the Court's prior decisions, and the Court accordingly should apply its ruling prospectively only. If, however, the Court should decide that its ruling should be applied retroactively, further remedial issues arise which, because they are so intertwined with issues of state law, should be remanded to the court below for resolution.

ARGUMENT

I. SUMMARY OF THE TAXPAYERS' CONSTITUTIONAL CLAIMS.

This case involves challenges to Washington's B&O tax under both the Commerce Clause, art. I, § 8, cl. 3, and Due Process Clause, amend. XIV, § 1, of the United States Constitution. In *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977) the Court laid down four tests for assessing the Commerce Clause validity of a state tax: (1) there must be a sufficient connection or nexus between the interstate activities and the taxing state; (2) the tax must not discriminate against interstate commerce; (3) the tax must be fairly apportioned; and (4) the tax must be fairly related to the services provided by the state.

The Due Process Clause sets forth two additional tests: (1) there must be a minimal connection between the interstate activities and the taxing state; and (2) there must be a rational relationship between the income attributed to the state and the intrastate values of the enterprise. *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 436-37 (1980). The Court has recognized that the Commerce Clause and Due Process Clause tests in the area of state taxation are similar. *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois*, 386 U.S. 753, 756 (1967).

To invalidate a state's tax, taxpayers must show that the challenged statute contravenes these standards. The Taxpayers both claim that the B&O tax violates the discrimination and fair apportionment prongs of the *Complete Auto* test. We will address these common claims first. We will then address the claims by TPI, under the Commerce and Due Process Clauses, that there is insufficient nexus for Washington to impose its tax and that the tax is not fairly related to the services provided by the state.

II. THE SELLING AND MANUFACTURING TAXES DO NOT DISCRIMINATE AGAINST INTERSTATE COMMERCE.

A. The Discrimination Prong of the Complete Auto Test Prohibits Discrimination while Permitting Fair Encouragement.

The discrimination test embodies two basic principles. First, a state is prohibited from imposing a tax "which discriminates against interstate commerce * * * by providing a direct commercial advantage to local business." *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 329 (1977). The second principle is the converse of the first. A state may structure its tax system "to encourage the growth and development of intrastate commerce or industry" or to "compete with other States for a share of interstate commerce" so long as it does not "discriminatorily tax the products manufactured or the business operations performed in any other State." *Boston Stock Exchange*, 429 U.S. at 336-37.

The line between the discrimination principle and the fair encouragement principle is simply this: A state tax law discriminates if it affects the direction of commerce, either by erecting barriers or by allowing an interstate business, already subject to a state's taxes, to *reduce* its tax burden in the state by *increasing* its business operations there. A state tax law constitutes fair encouragement when it treats local business and interstate commerce equally, allowing for tax neutral decision-making with regard to the direction of commerce.

The key is tax neutral decision-making with regard to the direction of commerce. Our discussion will focus on the Court's decisions establishing this proposition.

1. A tax discriminates if it erects barriers or induces nonresidents to increase their business within the state.

The Court has identified two kinds of taxes that affect the direction of interstate commerce and are thus discriminatory. The first seeks to protect local business by erecting a barrier against the flow of goods in interstate commerce. For example, in *Bacchus Imports, Ltd. v. Las*, 468 U.S. 263 (1984), the Court struck down an excise tax on the sale of liquor because certain locally produced liquor was exempt from the tax. The result was a tax on interstate commerce but not on local business. This constituted a barrier against interstate commerce which provided a direct commercial advantage to local business.

The second type of discriminatory tax is not designed as a barrier. It seeks instead to induce an interstate business, al-

ready subject to the state's tax, to increase business activity within the state. This inducement is brought about by allowing an interstate business to *reduce* its tax burden, in the taxing state, by *increasing* its business operations there. For example, in *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984) the interstate taxpayer was subject to New York's franchise tax. The tax could be reduced by the application of a credit and the amount of the credit increased as a business increased its percentage of shipping from New York ports. The Court struck down the credit because it *reduced* the business' New York tax burden, e.g., from \$420 to \$406, if the business *increased* its percentage of shipping out of New York from zero to one hundred percent. 466 U.S. at 400 n. 9 (Table A). The Court concluded that the tax was discriminatory because it foreclosed tax neutral decisions by inducing business into New York. In the words of the Court:

Whether the discriminatory tax diverts new business into the State or merely prevents current business from being diverted elsewhere, *it is still a discriminatory tax that "forecloses tax-neutral decisions and * * * creates * * * an advantage" for firms operating in New York by placing "a discriminatory burden on commerce to its sister States".* *Boston Stock Exchange*, 429 U.S., at 331.

466 U.S. at 406 (emphasis added).

The economic operation of the discriminatory taxes in *Bacchus* and *Westinghouse* is essentially the same. To avoid a barrier an interstate business must become a local business. Thus, an interstate business could avoid the barrier set up in *Bacchus* by moving its operation into Hawaii and qualifying for the exemption given to local business. In this way it would *increase* its business in Hawaii, while at the same time *reducing* its Hawaii tax burden.

2. Fair encouragement exists when local and interstate commerce are treated equally, allowing for tax neutral decision-making.

A state tax law constitutes fair encouragement instead of discrimination when it treats local and interstate commerce equally, allowing for tax neutral decision-making with regard to the direction of commerce. This distinction was explicitly recognized in *Boston Stock Exchange*, 429 U.S. 318 (1977)

which concerned the New York tax on stock transfers. The tax was imposed on five separate taxable events, including sales and transfer of securities. The tax applied if any one of these five events, e.g., transfer, occurred in New York even if other events, e.g., sale, took place in another state. However, if more than one event, e.g., both sale and transfer, occurred in New York, only one tax was payable on the entire transaction. 429 U.S. at 321-22.

Prior to the 1968 amendments the amount of the tax was the same wherever the sale took place. The 1968 amendments reduced the tax but only for those selling stock in New York, e.g., 30,000 shares selling at \$20 per share would be subject to a maximum tax of \$350 if both sold and transferred in New York and a tax of \$1,500 if transferred in New York and sold elsewhere. 429 U.S. at 334. The Court struck down the 1968 amendment because "the choice of exchange * * * is not made solely on the basis of nontax criteria. Because of the * * * transfer in New York, the seller cannot escape tax liability by selling out of State, but he can substantially reduce his liability by selling in State." 429 U.S. at 331.

In dicta, the Court contrasted the discriminatory amendments with the pre-1968 tax which did not have this vice. The pre-1968 tax was neutral because:

*[The tax] fell equally on all transactions regardless of the situs of the sale. Thus, the choice of an exchange for the sale of securities that would be transferred * * * in New York was not influenced by the transfer tax; wherever the sale was made, tax liability would arise. The flow of interstate commerce in securities was channeled neither into nor out of New York by the state tax.*

429 U.S. at 330 (emphasis added).

These decisions establish a bright line test for judging discrimination. Taxes that affect the flow of interstate commerce are discriminatory. Neutral taxes are not.

B. The Selling Tax Is Not Discriminatory because It Allows Tax Neutral Decision-Making.

The Taxpayers claim that the selling tax discriminates against interstate commerce. TPI Br. 14-17; NCC Br. 7-10. The selling tax has been sustained by the Court on three pre-

vious occasions. *General Motors Corp. v. Washington*, 377 U.S. 436 (1964); *Standard Pressed Steel Co. v. Department of Revenue of Washington*, 419 U.S. 560 (1975); *Chicago Bridge & Iron Co. v. Washington Department of Revenue*, 98 Wn.2d 814, 659 P.2d 463 (1983), *appeal dism'd*, 464 U.S. 1013 (1983). This time The Taxpayers' challenge is based primarily on *Maryland v. Louisiana*, 451 U.S. 725 (1981), although TPI also invokes *Armco, Inc. v. Hardesty*, 467 U.S. 638 (1984).

Our analysis of The Taxpayers' claim focuses on the test for discrimination. We will demonstrate that the selling tax does not create a barrier, as was the case in *Armco*, or entice interstate commerce into the state with reduced taxes, as was the case in *Maryland v. Louisiana*. The selling tax does not discriminate because it treats local and interstate commerce equally, allowing for tax neutral decision-making with regard to the direction of commerce.

1. The selling tax does not create a barrier or violate *Armco* because all sellers pay it.

The selling tax does not create a barrier and is not covered by *Armco*, 467 U.S. 638 (1984). In *Armco* the Court invalidated West Virginia's wholesaling tax. The flaw in the tax was that it applied *only* to sales in interstate commerce. The Court struck down the tax because "a State may not tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State." 467 U.S. at 642.

Washington's selling tax is not similarly flawed because it applies to *all* sales in this state. Goods manufactured in Washington and sold here are subject to selling tax and so are goods manufactured elsewhere and sold here. Washington does not tax a sales transaction more heavily when it crosses state lines.

2. An out-of-state manufacturer cannot reduce its Washington tax by manufacturing here.

The Taxpayers' main complaint with regard to the selling tax focuses on the operation of the multiple activities exemption, Wash. Rev. Code § 82.04.440, which provides that persons subject to selling tax are exempt from manufacturing tax *with respect to the product so sold*. The gravamen of their argument is that "local business is awarded an exemption from the manufacturing tax. Out-of-state manufacturers receive no comparable benefit." NCC Br. 8.

The Taxpayers' argument is frivolous. An out-of-state manufacturer, selling here, is *also* exempt from Washington's manufacturing tax, because its manufacturing activity does not take place "within this state". Wash. Rev. Code § 82.04.240. In essence The Taxpayers claim they do not receive an exemption from a manufacturing tax they never have to pay.

The selling tax and multiple activities exemption do not discriminate by enticing business into Washington, because an interstate business cannot *reduce* its tax burden in Washington by *increasing* its business here. An out-of-state manufacturer selling in Washington cannot reduce its Washington taxes by moving its manufacturing operation into this state. For example, a business that manufactures \$1,000 of goods elsewhere and sells them in Washington pays a selling tax of \$4.40 (\$1,000 x .0044). The business pays precisely the same amount of selling tax, \$4.40, if it moves its manufacturing operations into Washington and both manufactures and sells in this state. In neither case is the business subject to Washington manufacturing tax. Thus, the selling tax does not violate the test for discrimination laid down by the Court.

The Taxpayers try to show discrimination by comparing the business activities of local and interstate commerce without regard to the Washington tax their goods must bear. TPI Br. 15-16; NCC Br. 10. The Taxpayers' argument is simply this: A local business that both manufactures and sells a chair in Washington for \$1,000 engages in two business activities in this state (selling and manufacturing) and pays a selling tax of \$4.40. An interstate business that manufactures a chair elsewhere and sells it in Washington for \$1,000 engages in one business activity in Washington (selling) and pays a selling tax of \$4.40. The Taxpayers allege that Washington's system is discriminatory because a local business can engage in two business activities for the price of one.

The flaw in The Taxpayers' activity analysis is that it ignores the test for discrimination laid down by the Court. The Court has consistently looked to the "practical operation" of the tax to determine if it discriminated against interstate commerce. *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64, 69 (1963). Thus, the Court has consistently judged discrimination based on the relative tax burdens imposed on the

products of local and interstate commerce, even when the taxes are imposed on privileges relating to those products, as in this case.

For example, in *Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937) the Court considered the validity of Washington's use tax. Under the statute Washington imposed a tax on retail sales and a use tax for the privilege of using, within this state, any article of tangible personal property. The law also contained a provision similar to the multiple activities exemption which provided that use tax was not due if retail sales tax was paid. As in this case, the sales and use taxes were imposed on privileges. If one focuses solely on the activities, the sales and use taxes allow two for the price of one. Thus, a person buying a product locally engages in two taxable privileges, sales and use, but pays only retail sales tax. A person who buys elsewhere and brings a product into Washington engages in only one taxable privilege, use, but pays precisely the same tax.

The Court in *Silas Mason* sustained the imposition of use tax. It did not focus on the activities. Instead, the Court looked to the relative tax burden imposed on the goods.

When the account is made up, the stranger from afar is subject to no greater burdens as a consequence of ownership than the dweller within the gates. *The one pays upon one activity or incident, and the other upon another, but the sum is the same when the reckoning is closed.*

300 U.S. at 584 (emphasis added).

Thus, focusing on activities does not demonstrate discrimination. The question is whether the practical operation of the tax establishes barriers or entices business into the state. Based on this test Washington's so-called "two for one" does not discriminate.

TPI's reliance on the "two for one" argument is particularly misplaced, since TPI is not a manufacturer. Products sold by TPI in Washington are manufactured by separate corporations, Tyler Pipe Industries of Texas, Inc. and Tyler Plastics Co. J.A. 135; TPI Br. 4. Even if TPI moved into Washington it would never be subject to a manufacturing tax, because it does not engage in any manufacturing activity. Thus, even if the Court concluded that the selling tax did discriminate against out-of-state manufacturers, that conclu-

sion would have no application to TPI.

Unlike the tax in *Bacchus*, 468 U.S. 263 (1984), the selling tax does not impose a barrier to interstate commerce because it is imposed on interstate and local sales alike. Unlike the taxes in *Westinghouse*, 466 U.S. 388 (1984) and *Boston Stock Exchange*, 429 U.S. 318 (1977), the tax provides no incentive for an interstate manufacturer, that sells in Washington, to move its manufacturing operation into this state — because the total Washington tax due will remain exactly the same. Thus, Washington's selling tax does not discriminate against interstate commerce. The tax treats local business and interstate commerce equally, allowing for tax neutral decision-making with regard to the direction of commerce.

3. Maryland v. Louisiana is distinguishable because a business could reduce its Louisiana tax by increasing its Louisiana business.

The Taxpayers argue that the multiple activities exemption discriminates against interstate commerce in the same way as the first use tax credit struck down in *Maryland v. Louisiana*, 451 U.S. 725 (1981). TPI Br. 16; NCC Br. 7-9. The first use tax was imposed on natural gas brought into Louisiana from the Outer Continental Shelf (OCS). Louisiana also imposed a severance tax on gas severed in Louisiana. The law provided that "an owner paying the First-Use Tax on OCS gas receives an equivalent tax credit on any state severance tax owed in connection with production in Louisiana." 451 U.S. at 756 (emphasis added). Thus, the credit received for paying first use tax on OCS gas could be applied to reduce severance tax that would otherwise be due on gas severed in Louisiana (*non-OCS*). The Court found the credit discriminatory, as it encouraged "natural gas owners involved in the production of OCS gas to invest in mineral exploration and development within Louisiana". 451 U.S. at 757. The economic incentive was that a business could *reduce* its Louisiana tax burden, e.g., from \$70 to \$35 if it *increased* its business in Louisiana. 451 U.S. at 757 n. 28.

This is the same reason the Court struck down the taxes in *Boston Stock Exchange*, 429 U.S. 318 (1977) and *Westinghouse*, 466 U.S. 388 (1984). In each of these three cases the law was discriminatory because taxes could be *reduced*, in the

taxing state, by increasing business there.

The multiple activities exemption does not have this flaw. The credit in *Maryland v. Louisiana* and the multiple activities exemption differ significantly in that the multiple activities exemption only applies to products which have been subjected to selling tax. Thus, selling tax paid on the sale of a chair provides a manufacturing tax exemption on making the chair. It applies to no other product, such as a table. See *Crown Zellerbach Corp. v. State*, 45 Wn.2d 749, 756, 278 P.2d 305 (1954). As a result, the multiple activities exemption does not result in reduced Washington tax. In contrast, in *Maryland v. Louisiana* the first use tax on OCS gas was applied to a completely different product, non-OCS gas. The credit reduced taxes in Louisiana by lowering or eliminating a severance tax which would otherwise be paid.

C. The Manufacturing Tax Is Not Discriminatory, since It Complements the Selling Tax; Both Taxes Apply Equally to Commerce, Allowing Tax Neutral Decision-Making.

NCC also challenges the imposition of manufacturing tax on goods it manufactures in Washington and sells elsewhere. Since the goods are sold elsewhere, there is no selling tax paid on the sale and the multiple activities exemption does not operate. NCC contends that the manufacturing tax thus imposed violates the discrimination prong of the *Complete Auto* test. NCC Br. 5-7. For NCC's contention to have merit one must view the manufacturing tax in isolation without reference to the selling tax.

We agree that if the manufacturing tax stood alone it would be discriminatory because it applies primarily to interstate commerce. However, the manufacturing tax does not stand alone. As we have seen, a Washington manufacturer who sells here is subject to selling tax. The Court has long recognized that a tax imposed primarily on interstate commerce is not discriminatory if it compensates for a tax imposed on local commerce.⁷

⁷ See Hellerstein, *Complementary Taxes as a Defense to Unconstitutional State Tax Discrimination*, 39 Tax Lawyer 405 (1986), which provides an extended view of the development of the law in this area. However, the author's proposed criteria for compensating taxes depart radically from criteria laid down by the Court.

The Court's seminal compensating tax decision, *Silas Mason*, 300 U.S. 577 (1937) illustrates the reason compensating taxes are not discriminatory. In *Silas Mason*, the Court addressed Washington's use tax and compared it to Washington's retail sales tax. The rate and measure of these two taxes were the same. Washington law also exempted from the use tax goods subject to retail sales tax. 300 U.S. at 579-81. As a result, the use tax applied primarily to goods purchased out of state and brought into Washington. The Court ruled there was no discrimination because:

Equality exists when the chattel subjected to the use tax is bought in another state and then carried into Washington. It exists when the imported chattel is shipped from the state of origin under an order received directly from the state of destination. In each situation the burden borne by the owner is balanced by an equal burden where the sale is strictly local.

300 U.S. at 584.

Thus, compensating taxes do not discriminate because, when the two taxes are considered together, local business and interstate commerce are treated equally, allowing for tax neutral decision-making. As the Court said in *Boston Stock Exchange*, 429 U.S. 318, 332 (1977):

In all the use tax cases, an individual faced with the choice of an in-state or out-of-state purchase could make that choice without regard to the tax consequences. If he purchased in State, he paid a sales tax; if he purchased out of State but carried the article back for use in State, he paid a use tax of the same amount. The taxes treated both transactions in the same manner. (Emphasis added.)

With this background, we begin our analysis by explaining the criteria for establishing a compensating tax. We will then focus on NCC's lone argument that the manufacturing tax is not a compensating tax. Finally, we will demonstrate that the manufacturing tax meets the compensating tax criteria laid down by the Court.

- 1. Compensating taxes must be designed to achieve equality and actually result in equal treatment of local and interstate commerce.**

"The common thread running through the cases uphold-

ing compensatory taxes is the equality of treatment between local and interstate commerce." *Maryland v. Louisiana*, 451 U.S. 725, 759 (1981). This equality exists if the two taxes being compared are designed to achieve equality and actually result in equal treatment of in-state and out-of-state taxpayers similarly situated. Taxes that do not meet both criteria are not compensating taxes.

For example, in *Maryland v. Louisiana*, the first use tax and severance tax were not designed to achieve equality. Although the rate and measure of the two taxes were the same:

[T]he pattern of credits and exemptions allowed under the Louisiana statute undeniably violates this principle of equality. As we have said, OCS gas may generally be consumed in Louisiana without the burden of the First-Use Tax. Its principle application is to gas moving out of the State. Of course, it does equalize the tax burdens on OCS gas leaving the State and Louisiana gas going into the interstate market. But this sort of equalization is not the kind of "compensating" effect that our cases have recognized.

451 U.S. at 759.

Even two taxes designed to achieve equality are not compensating taxes unless they actually result in equal treatment of local and interstate commerce. For example, in *Halliburton*, 373 U.S. 64 (1963), the Court struck down Louisiana's use tax even though the state also imposed a retail sales tax in the same pattern approved in *Silas Mason*, 300 U.S. 577 (1937). Obviously, a sales and use tax are designed to achieve equality, but the Louisiana use tax did not actually achieve it. Although the rate of the two taxes was the same, the measure of the use tax was higher because it included labor and shop overhead. The measure of the sales tax did not. *Halliburton*, 373 U.S. at 67. The Court refused to sustain the use tax because "disparate treatment would be an incentive to locate within Louisiana". 373 U.S. at 72.

2. Armco does not stand for the proposition that Washington's manufacturing and selling taxes are not compensating taxes.

NCC's main challenge to the manufacturing tax is predicated on its contention that Washington's selling and manu-

facturing taxes are not compensating taxes. NCC Br. 14-15. NCC's compensating tax argument is based solely on the passage in *Armco*, 467 U.S. 638, 643 (1984), stating that manufacturing and wholesaling are not "substantially equivalent events". NCC Br. 14. From this phrase NCC concludes that no tax on manufacturing can ever compensate for a tax on selling, even if both taxes treat local business and interstate commerce in an equal manner.

NCC's argument is wrong for four reasons. First, the argument totally ignores the basis for all of the Court's compensating tax decisions, which is: are the taxes designed to achieve equality and do they actually result in equal treatment of local and interstate commerce? The Court has consistently applied these criteria in its decisions sustaining the compensating tax, as in *Silas Mason*, 300 U.S. 577 (1937), and its decisions striking down noncompensating taxes, as in *Halliburton*, 373 U.S. 64 (1963).

Even *Maryland v. Louisiana*, 451 U.S. 725 (1981), where the phrase "substantially equivalent event" first appears, was decided on this basis. In *Maryland v. Louisiana* the Court's decision was not based on some notion of the equivalency of events. It was based on the fact that Louisiana's taxing statutes were not designed to achieve equality. The Court stated:

The two events [severance in Louisiana of non-OCS gas and use of OCS gas in Louisiana] are not comparable in the same fashion as a use tax complements a sales tax. In that case, a State is attempting to impose a tax on a substantially equivalent event to assure uniform treatment of goods and materials to be consumed in the State. No such equality exists in this instance. * * * [T]he pattern of credits and exemptions allowed under the Louisiana statute undeniably violates this principle of equality.

451 U.S. at 759. Thus, NCC's reliance on a substantially equivalent events test constitutes a radical departure from the compensating tax criteria evolved by the Court over the years.

The second flaw is that NCC misreads *Armco*. That case does not stand for the proposition that selling and manufacturing taxes can never be compensating taxes, any more than *Halliburton* stands for the proposition that sales and use taxes can never be compensating taxes. NCC takes the phrase "substantially equivalent events" out of context. What the Court actually said was:

Here, too, manufacturing and wholesaling are not "substantially equivalent events" such that the heavy tax on in-state manufacturers can be paid to compensate for the admittedly lighter burden placed on wholesalers from out of State.

Armco, 467 U.S. at 643 (emphasis added). When the phrase is placed in context, it is apparent that the Court is speaking only of West Virginia's wholesaling and manufacturing taxes, not selling and manufacturing taxes in general.

The Court went on to analyze West Virginia's wholesaling and manufacturing taxes based on the traditional criteria for identifying a compensating tax. The Court concluded that the manufacturing and wholesaling taxes were not designed to achieve equality because of differences in the rate and measure of the two taxes. The Court's analysis continues:

Manufacturing frequently entails selling in the State, but we cannot say which portion of the manufacturing tax is attributable to manufacturing, and which portion to sales. The fact that the manufacturing tax is not reduced when a West Virginia manufacturer sells its goods out of State, and that it is reduced when part of the manufacturing takes place out of State, makes clear that the manufacturing tax is just that, and not in part a proxy for the gross receipts tax imposed on *Armco* and other sellers from other States.

467 U.S. at 643 (footnotes omitted). Thus, it was the practical difference in the rate and measure of the two taxes that led the Court to rule that they were not compensating taxes. The Court did not base its analysis on the non-equivalence of manufacturing and selling.

It should also be noted that West Virginia's taxes did not actually result in equal treatment of local and interstate commerce. Since the measure of the manufacturing tax was reduced if part of the manufacturing took place outside the state, the possibility existed that the lower tax base could outweigh the effects of the higher manufacturing tax rate. In such cases, the West Virginia tax burden would actually be reduced by increasing the taxpayer's manufacturing activity in West Virginia.⁸ Of course, this was also the basis for striking down

⁸For example, a product manufactured elsewhere and sold in West Virginia for \$1,000 was subject to wholesaling tax of \$2.70 (\$1,000 x .0027). If the same product was manufactured partially within and without West Vir-

the taxes in *Boston Stock Exchange*, 429 U.S. 318 (1977); *Maryland v. Louisiana*; and *Westinghouse*, 466 U.S. 388 (1984).

The third reason NCC's compensating tax argument is wrong is that it directly conflicts with *Hinson v. Lott*, 8 Wall. 148 (1869). The Court there held that taxes on a selling activity and a manufacturing activity were compensating taxes. In *Hinson* the plaintiff challenged an Alabama tax on the introduction of liquor into the state for sale. The tax was measured by the number of gallons imported and the rate of tax was 50¢ per gallon. On its face this tax appears discriminatory because it was imposed only on liquor brought into Alabama from other states. However, the Court sustained the tax because Alabama also imposed a tax on liquor manufactured in the state, at precisely the same rate and measure as the challenged tax — 50¢ per gallon. When the two taxes were considered together, the Court concluded that the challenged tax was non-discriminatory because "no greater tax is laid on liquors brought into the State than on those manufactured within it." 8 Wall. at 153.

A flat rule that manufacturing and selling can never be substantially equivalent events would be completely inconsistent with *Hinson*. The relevance and importance of *Hinson* stems not just from its holding, but also from the fact that it was cited as controlling in *Silas Mason*, 300 U.S. at 585. Thus, in what generally is viewed as the Court's most important compensating tax decision, a tax on manufacturing and a tax upon importation for sale were clearly treated as compensating taxes.

The fourth reason NCC's argument is wrong is that its reading of *Armco* results in an essentially meaningless test.⁹ NCC claims that taxes must be on "substantially equivalent events" to have a valid compensating tax. NCC Br. 15 n. 17. Yet NCC does not explain how such a test is to be applied, short of weighing the equivalence of various activities on some metaphysical scale.

ginia and if the manufacturing tax base was reduced from \$1,000 to \$250, then the manufacturing tax on the same product sold in West Virginia would be \$2.20 (\$250 x .0088).

⁹"[T]he formal differences in the legal incidences of the two taxes do not provide an analytically defensible ground of distinction." Hellerstein, *supra* p. 22 n. 7, at 432.

The problem with NCC's proposed test can be demonstrated by comparing the equivalence of the activities of sales and use with the equivalence of the activities of manufacturing and selling. *Silas Mason* establishes that a use tax on the privilege of use can be a valid compensating tax for a retail sales tax imposed on the activity of purchasing at retail. Thus, even NCC must concede that sales and use taxes are imposed on substantially equivalent events.

However, no logical distinction exists between the substantial equivalence of the activities of sales and use and the substantial equivalence of the activities of manufacturing and selling. Sales and use are separate and distinct activities. There can be use without sale, but there cannot be a retail sale without use. Similarly, manufacturing and selling are separate activities. There can be manufacturing without a sale, but there cannot be a sale of manufactured articles without manufacturing. Indeed, the Court recognized the similarity in these two sets of relationships in *Silas Mason* where the Court cited *Hinson* to support its conclusion that the use tax was a valid compensating tax for the sales tax. *Silas Mason*, 300 U.S. at 585.

NCC's substantially equivalent events test does not withstand analysis. It is inconsistent with compensating tax criteria laid down by the Court. The test is based on a misreading of *Armco* and is directly contrary to the Court's holding in *Hinson*. Finally, the test is of no analytical value whatsoever.

3. The selling and manufacturing taxes are designed to achieve equality and actually result in equal treatment of local and interstate commerce.

Washington's manufacturing tax meets the compensating tax criteria laid down by the Court. First, the selling and manufacturing taxes are designed to achieve equality. Unlike the West Virginia wholesaling and manufacturing taxes in *Armco*, 467 U.S. 638 (1984), Washington's selling and manufacturing taxes have the same rate and measure. They are designed to tax equally all goods sold or manufactured in Washington.¹⁰

¹⁰The complementary operation of the two taxes is a neutral consideration for in-state manufacturers deciding where to market their products, and thus in contrast to those state regulatory measures the Court has de-

The Washington Supreme Court recognized this design as early as 1954 when it rejected the precise claim made by NCC, that the manufacturing tax was discriminatory because only interstate manufacturers pay it. The Washington Supreme Court stated:

[A]s a purely practical matter in terms of a program envisaging imposition of the business and occupation tax upon only one taxable activity, it may be said that a local manufacturer, selling in intrastate commerce, pays a business and occupation tax upon its wholesaling activity.

Crown Zellerbach Corp., 45 Wn.2d 749, 759, 278 P.2d 305 (1954).¹¹

Second, the selling and manufacturing taxes actually result in equal treatment of local and interstate taxpayers similarly situated. NCC demonstrates this fact perfectly. It pays an identical tax of \$4.40 (\$1,000 x .0044) whether it manufactures and sells \$1,000 of goods in Washington; sells goods in Washington manufactured elsewhere; or sells elsewhere goods produced in Washington.

The selling and manufacturing taxes have precisely the same economic effect as the compensating taxes in *Hinson*, 8 Wall. 148 (1869) and *Silas Mason*, 300 U.S. 577 (1937). Washington's manufacturing tax, when considered with the selling tax, does not provide a direct commercial advantage to local business. The two taxes treat local and interstate commerce in an equal manner, allowing for tax neutral decision-making. Thus, the manufacturing tax does not discriminate against interstate commerce.

D. Washington's Manufacturing Tax, a Valid Compensating Tax, Is Not Rendered Discriminatory by the Concept of Internal Consistency.

clared "off-limits" under the Commerce Clause. See, e.g., *New England Power Co. v. New Hampshire*, 455 U.S. 331, 339 (1982).

¹¹NCC cites *Columbia Steel Co. v. State*, 30 Wn.2d 658, 192 P.2d 976 (1948) to create the impression that Washington, itself, does not view the manufacturing and selling taxes as compensating taxes. NCC Br. 15 n. 17. In *Columbia Steel* the court did not even address the question of whether the manufacturing and selling taxes should be considered together. In *Crown Zellerbach* the court considered the two taxes together and concluded that they were complementary. It is this difference in analysis that distinguishes *Columbia Steel* and *Crown Zellerbach*.

NCC raises one additional argument in relation to the compensating tax question. According to NCC: "Even if Washington's taxes are viewed as 'compensatory,' they discriminate against interstate commerce." NCC Br. 12. NCC's argument is based on the reference to internal consistency in *Armco*, 467 U.S. 638, 644 (1984). NCC Br. 12-13 n. 14.¹² We begin our analysis by showing that NCC has taken the internal consistency phrase out of context. The concept has never been used to strike down an otherwise valid compensating tax.

1. Armco did not apply the concept of internal consistency to strike down an otherwise valid compensating tax.

The Court in *Armco*, 467 U.S. 638 (1984) did not strike down West Virginia's wholesaling tax on the basis of "internal consistency". Once again, NCC has taken a phrase from *Armco* out of context. The Court's mention of internal consistency was dicta, the Court having concluded already that West Virginia's wholesaling tax was discriminatory because it was not a compensating tax. Despite this fact West Virginia argued that *Armco* be required to prove actual discriminatory impact. 467 U.S. at 644. The Court rejected this argument stating:

This is not the test. In *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 169 (1983), the Court noted that a tax must have "what might be called internal consistency — that is the [tax] must be such that, if applied by every jurisdiction," there would be no impermissible interference with free trade.

467 U.S. at 644. The Court carefully limited its discussion in *Armco* to situations where a tax is *facially discriminatory*:

In [*Container*], the Court was discussing the requirement that a tax be fairly apportioned to reflect the business conducted in the State. A similar rule applies where the allegation is that a tax on its face discriminates against interstate commerce.

467 U.S. at 644 (emphasis added).

¹²Even if the Court in *Armco* intended to apply internal consistency to a compensating tax, its application would be limited to Washington's manufacturing tax. It would not apply to Washington's selling tax which is imposed on *all* sales in Washington. Thus, in *Armco* when the Court struck down the wholesaling tax there was no indication that the manufacturing tax which was imposed on *all* West Virginia manufacturers was similarly invalid.

Obviously, the reference to internal consistency does not apply to a valid compensating tax. By definition a compensating tax does not discriminate on its face against interstate commerce because local and interstate businesses are treated in an equal manner.

2. NCC's internal consistency test conflicts with the Court's compensating tax decisions.

NCC's argument is wrong because it would result in striking down compensating taxes specifically approved by the Court. Under NCC's test the challenged taxes of State A are projected into State B. NCC claims that even valid compensating taxes are discriminatory if interstate commerce pays two taxes *e.g.*, one in State A and one in State B, and local business pays one tax.

Under this test the compensating taxes in both *Hinson*, 8 Wall. 148 (1869) and *Southern Pacific Co. v. Gallagher*, 306 U.S. 161 (1939) would be adjudged discriminatory. If the Alabama taxes approved in *Hinson* were projected into another state, *e.g.*, State A, the result would be as follows: An interstate business pays two taxes, the State A tax on manufacturing liquor and the Alabama tax on introducing liquor into the state for sale. On the other hand, a local business manufacturing and selling liquor in Alabama pays one tax, the Alabama manufacturing tax. The result is the same for the situation addressed in *Southern Pacific* where the Court sustained the imposition of California's tax based on its earlier decision in *Silas Mason*, 300 U.S. 577 (1937). In both *Hinson* and *Southern Pacific* the Court ruled that the compensating taxes at issue were nondiscriminatory. NCC's internal consistency test is in direct conflict with these decisions.

This conflict is not coincidental. The Court has specifically refused to apply an internal consistency requirement to otherwise valid compensating taxes.

The question of internal consistency first arose in *Silas Mason*. The sales and use tax at issue there is one of the few compensating taxes approved by the Court that could pass NCC's internal consistency test. This is because Washington provided a credit against Washington use tax for sales tax paid in other states. 300 U.S. at 580-81. Thus, if Washington's sales and use taxes were projected into another state, *e.g.*, State A,

both interstate and local business would pay one tax. Interstate commerce pays sales tax in State A but no Washington use tax is due because of the credit. Similarly, a local business both buying and using goods in Washington pays one tax, Washington's sales tax. While the credit made Washington's tax internally consistent, in the sense NCC argues, the Court specifically refrained from ruling on whether the credit was constitutionally required. 300 U.S. at 587.

In *Southern Pacific* the Court sustained California's use tax even though it lacked internal consistency, owing to the absence of the credit provision found in the Washington system. The Court specifically refused to apply an internal consistency test by projecting California's taxes into another state because:

It will be time enough to resolve that argument "when a taxpayer paying in the state of origin is compelled to pay again in the state of destination."¹²

¹²*Henneford v. Silas Mason Co.*, 300 U.S. 577, 587.

306 U.S. at 172.

In *Williams v. Vermont*, 472 U.S. ___, 105 S.Ct. 2465, 2471 (1985) the Court reaffirmed its ruling in *Southern Pacific* and again refused to consider a Commerce Clause discrimination claim based on the absence of the credit, which was really an internal consistency claim. Thus, the Court has never invalidated an otherwise valid compensating tax based on internal consistency. NCC's argument that the manufacturing tax should be struck down even though it is a valid compensating tax should be similarly rejected.

Finally, *Southern Pacific* puts into focus what is really at stake in NCC's efforts to use the concept of internal consistency to strike down an otherwise valid compensating tax. To have granted the taxpayer relief in *Southern Pacific* would have amounted to granting it preferential treatment over local taxpayers, for California relieved local taxpayers of a use tax only if a sales tax had actually been paid on the same item. The taxpayer in *Southern Pacific*, however, was claiming that it should be relieved of the use tax even if it had paid no sales tax to California or to any other state on that same item.

Here too, NCC is asking that Washington be required to provide relief from a compensating tax in order to offset taxes which it in fact does not pay, while local taxpayers obtain

tain relief from that same tax only as an offset for taxes which they in fact do pay, and that, as in *Southern Pacific*, amounts to a claim for preferential treatment.

III. WASHINGTON'S SELLING AND MANUFACTURING TAXES ARE PROPERLY APPORTIONED ACCORDING TO THE COURT'S PRIOR HOLDINGS.

The Taxpayers also claim that Washington's selling and manufacturing taxes violate the second prong of the *Complete Auto* test, the requirement that a tax be fairly apportioned. TPI Br. 17; NCC Br. 15-17.¹³ We begin by correcting NCC's mischaracterization of the measure of the selling and manufacturing taxes. We will then review the decisions of the Court which uphold the apportionment of these taxes and show that no multiple burden exists in this case.

NCC's apportionment argument is based on its contention that "Washington's manufacturing tax and selling taxes are based on 100% of the gross receipts from [its] activities in Washington and other states" while other states can and do impose taxes on these same receipts. NCC Br. 17. NCC's description of the measure or base of Washington's selling and manufacturing taxes is incorrect.

The record proves that Washington does not base its taxes on "100% of the gross receipts" from NCC's activities in Washington and all other jurisdictions. In 1983 NCC's gross receipts from sales alone were approximately \$1.552 billion. J.A. 181 ¶ 13. Washington's selling tax was based on approximately \$110 million, which represents NCC's "gross proceeds of sales" in Washington that year.¹⁴ J.A. 181 ¶ 13. The man-

¹³While TPI challenges the apportionment of Washington's wholesaling tax, its only argument is subsumed in its claim that the tax is not fairly related to the services provided by the state under the fourth prong of the *Complete Auto* test. We address this argument *infra*, section IV(B), pp. 42-44.

¹⁴Only a small part of the \$110 million of Washington sales involved goods manufactured in another state. NCC's Washington sales of goods manufactured elsewhere ranged from \$19.9 to \$32 million between 1981 and 1984. J.A. 180 ¶ 9. In contrast, NCC's Washington sales of goods manufactured in the state ranged from \$71.4 to \$78.5 million between 1981 and 1984. J.A. 181 ¶ 11.

factoring tax was based on approximately \$18.7 million,¹⁵ which represents the “value of products” NCC manufactured in Washington and sold elsewhere, as determined by their selling price. J.A. 180 ¶ 10. Thus, NCC’s Washington tax was actually based on approximately \$128.7 million out of total gross sales receipts of approximately \$1.552 billion.

We now turn to the Court’s decisions pertaining to the measure of gross receipts taxes. The Court has consistently sustained gross receipts taxes that have been both imposed on a local activity or transaction and measured by the value of that activity or transaction.

Selling and manufacturing are both local privileges granted by the state, and another state cannot tax the privileges of engaging in selling and manufacturing activities in Washington. The Court has ruled that the delivery state is the only state that can tax the sale of goods, striking down sales taxes imposed by states other than the delivery state. See *Euco v. Jones*, 409 U.S. 91 (1972) and *J. D. Adams Manufacturing Co. v. Storen*, 304 U.S. 307 (1938). The same is true of manufacturing. Because the manufacturing activity takes place here, Washington is the only state that can tax that activity. In this respect manufacturing is similar to the severance discussed in *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 617 (1981) where the Court stated:

Nor is there any question here regarding apportionment or potential multiple taxation, for as the state court observed, “*the severance can occur in no other state*” and “*no other state can tax the severance*.” (Emphasis added.)

It is also well established that the gross proceeds of sales provide a proper value for the selling and manufacturing activities that take place in the state. In *Standard Pressed Steel*, 419 U.S. 560, 564 (1975) the Court stated that Washington’s selling tax measured by the gross proceeds of sales was “apportioned exactly to the activities taxed”. The Court cited this statement from *Standard Pressed Steel* with approval in *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 280

¹⁵The parties’ stipulation provides that NCC’s annual out-of-state sales of products manufactured in Washington ranged from \$11.3 to \$18.7 million between 1981 and 1984. The record does not reflect a specific amount for the year 1983. J.A. 180 ¶ 10.

(1978). More recently, the imposition of Washington’s selling tax, measured by the gross proceeds of sales, was approved in *Chicago Bridge & Iron*, 98 Wn.2d 814, 659 P.2d 463 (1983), *appeal dism’d*, 464 U.S. 1013 (1983). The Court has also approved manufacturing taxes measured by the value of the products, as determined by the selling price of the goods. See *American Manufacturing Co. v. St. Louis*, 250 U.S. 459, 462-63 (1919); *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250, 258 (1938). As the Court stated in *Freeman v. Hewit*, 329 U.S. 249, 258 (1946): “It has long been settled that a state can levy [a manufacturing] occupation tax graduated according to the volume of manufacture.”

These decisions firmly establish that the selling and manufacturing taxes are fairly apportioned. The only contrary authority cited by NCC is *Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434 (1939). The tax in *Gwin, White* was different from the selling and manufacturing taxes. The tax was imposed on “engaging * * * in any business activity,” not a local activity like selling or manufacturing, and the tax was measured by the “gross income of the business” not the value of the local activity. 305 U.S. at 435.

The Court has recognized that the analysis in *Gwin, White* does not apply to selling and manufacturing taxes like the ones at issue here. In *Standard Pressed Steel* the Court specifically distinguished *Gwin, White* in reaching its conclusion that the selling tax was “apportioned exactly to the activities taxed”. 419 U.S. at 564. In *Gwin, White*, itself, the Court distinguished and approved the imposition of the manufacturing tax involved in *American Manufacturing*, 305 U.S. at 440.

The fact that a state imposes a tax on a local activity, measured by the value of that activity, does not create a multiple burden nor require additional apportionment. Incorporating the position of the *amicus curiae* Amcord, et al., NCC also argues that the use of the same gross receipts, employed to measure Washington’s selling and manufacturing taxes, in the income tax base of some other state creates a prohibited multiple tax burden and thereby requires an additional apportionment of Washington’s tax. The Court rejected this same contention in *Exxon Corp. v. Department of Revenue of Wisconsin*, 447 U.S. 207 (1980), where the taxpayer argued it was subject to such a multiple burden because other states im-

posed severance taxes on the extraction of oil and gas. The Court ruled that this did not constitute a multiple burden because:

Severance taxes * * * are directed at the gross value of the mineral extracted or the quantity of production rather than the net income derived from the production activities. * * * The Wisconsin Supreme Court therefore properly concluded that "[t]he fact that the producing states may impose * * * severance taxes which have been held to be occupation taxes or property taxes does not render unfair or unconstitutional Wisconsin's efforts to reach a proportionate share of the taxpayer's income." 90 Wis.2d at 731, 281 N.W.2d at 110-11.

477 U.S. at 228-29 n. 12 (citations omitted).

Most recently, *Armco*, 467 U.S. 638, 645 (1984) indicates that there would be no constitutional infirmity if Ohio imposed a manufacturing tax and West Virginia imposed a selling tax. Yet clearly that situation would also involve the possibility of overlapping tax bases.

It is also important to remember that formulary apportionment of gross receipts taxes such as the selling and manufacturing taxes does not solve the problem of overlapping tax bases. Even if all states were required to use formulary apportionment there could still be overlapping tax bases unless the Court specified a particular type of formula, e.g., three factors. This was precisely the problem before the Court in *Moorman*, 437 U.S. 267 (1978). Since Iowa used a one factor formula to apportion its income tax, there was a possibility of overlapping tax bases with other states that used three factor formulas to apportion their income taxes. The Court recognized that to cure this problem "would require national uniform rules for the division of income." 437 U.S. at 279. The Court refused to take this step because Congress was better equipped to give due consideration to the interests of the various states. 437 U.S. at 280.

IV. THE SELLING TAX IS IMPOSED ON A SUFFICIENT NEXUS AND IS FAIRLY RELATED TO SERVICES PROVIDED.

TPI raises two Commerce and Due Process Clause issues

of its own.¹⁶ First and foremost, TPI claims that there is an insufficient nexus between its activities and the State of Washington. TPI Br. 10-13. TPI chiefly argues that the activities performed on its behalf in Washington constitute mere solicitation of sales which is insufficient to create a tax nexus. Second, TPI claims that imposition on it of the same tax rate and measure as on in-state taxpayers engaged in more activities means that the tax is not rationally or fairly related to values or services in Washington. TPI Br. 17-19.

The real nexus issue, however, is the same as it has long been: has the taxpayer "established that such services as were rendered * * * [through in-state activity] were not decisive factors in establishing and holding this market"? *General Motors*, 377 U.S. 436, 448 (1964), quoting *Norton Co. v. Department of Revenue of Illinois*, 340 U.S. 534, 538 (1951). See *Standard Pressed Steel*, 419 U.S. 560, 562 (have the in-state activities "made possible the realization and continuance of valuable contractual relations" between the taxpayer and others?). This is the decisive issue, regardless of whether the local activities consist only of "solicitation" or whether the agents performing them are employees or independent contractors. We will show that TPI has not carried its burden under this test.

TPI's second claim is refuted by the very case it cites.

A. The Solicitation and Other Local Activities Performed on TPI's Behalf Create a Sufficient Nexus for a Gross Receipts Tax.

1. Local solicitation alone creates nexus.

Contrary to TPI's first claim, in-state solicitation by state residents creates a sufficient tax nexus.

This is perhaps best illustrated by *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959). The cases consolidated there each involved a taxpayer whose in-state activities consisted of regular solicitation of orders,

¹⁶Even if the Court somehow rules that the selling tax is discriminatory against NCC due to the multiple activities exemption, these TPI issues will remain. TPI incurs only selling tax liability because it *engages only in selling* and does no manufacturing, not because of the multiple activities exemption. See *supra* pp. 4, 20-21. Thus, TPI cannot conceivably prevail on its discrimination claim.

through one or more employee salesmen operating from an in-state office. Orders were transmitted to and shipped from an out-of-state facility. 358 U.S. at 454-56. This Court held that net income from the interstate operations was subject to state taxation which was not discriminatory and was properly apportioned to local activities "forming sufficient nexus". 358 U.S. at 452. The Court concluded that the taxpayers' in-state activities, constituting "substantial income-producing activity in the taxing States", formed such a "nexus." 358 U.S. at 465. In short, *Northwestern States* holds that solicitation alone can create nexus.¹⁷

This contradicts TPI's claim that "solicitation of sales" is insufficient. TPI Br. 11. TPI cites *Robbins v. Shelby County Taxing District*, 120 U.S. 489 (1887), but the Court long ago noted that the *Robbins* rule "has been narrowly limited to fixed-sum license taxes imposed on the business of soliciting orders for the purchase of goods to be shipped interstate". *McGoldrick v. Berwind-White Coal Mining Co.*, 309 U.S. 33, 57 (1940). Here, in contrast, the B&O tax is imposed on the privilege of making sales in Washington, measured by the gross proceeds of those sales. Wash. Rev. Code §§ 82.04.220 and 82.04.270, TPI J.S. G-2-4. Moreover, even a (reasonable) license tax would likely survive now under the *Complete Auto* test.¹⁸

¹⁷*Northwestern States* prompted enactment of Public Law 86-272, 15 U.S.C. §§ 381 *et seq.*, TPI J.S. G-1-2. Cf. TPI Br. A-1-5. The effect of that act is not among the Questions Presented, TPI J.S. i-ii, and thus is not before the Court. In any event, that act is inapplicable, according to the Washington Supreme Court's unchallenged holding, because the "B&O tax is not a net income tax". TPI J.S. A-9; TPI Br. 13 n. 12. Even if it did apply, the representatives' activities here go far beyond the mere "solicitation of orders" which is tax-exempt under that act, as will be reiterated momentarily. There is no basis for this Court to expand that act to these other activities, and to a gross receipts tax, when Congress itself has not seen fit to do so. The real significance of the act here is to show that Congress regarded "solicitation" by "independent contractors" as constitutionally creating a tax nexus, which directly refutes TPI's chief contention. Otherwise, there would have been no reason for the act's restrictions.

¹⁸*Robbins* is also inapposite because it involved non-resident solicitors and thus only barred "taxes upon persons passing through the state, or coming into it merely for a temporary purpose" such as itinerant drummers." *Northwestern States*, 358 U.S. at 458. Here, of course, TPI's representatives are Washington residents.

The *Northwestern States* rule that local solicitation by itself can create sufficient nexus, unlike the contrary rule urged by TPI, makes sense. There is no conceivable reason to deny recognition of nexus based upon the very local activities directly giving rise to the in-state sales.

2. All of the local activities here create nexus.

In focusing on solicitation, TPI dismisses the numerous other functions which the courts below found were also performed on TPI's behalf by its local representatives, as being "simply the sticks that make up the bundle of sales solicitation." TPI Br. 13 n. 11. This semantic exercise, if successful, would merely bring the case under *Northwestern States*, 358 U.S. 450 (1959). It cannot succeed, though, because the functions here go well beyond solicitation and thus also satisfy the nexus analysis in *Standard Pressed Steel*, 419 U.S. 560 (1975).

The taxpayer in *Standard Pressed Steel* was an out-of-state manufacturer with one employee, Martinson, operating from his home in Washington. His primary duty was to consult with the Boeing Company regarding its anticipated needs for aerospace fasteners and to follow up any difficulties in their use. Martinson was assisted by a group of the taxpayer's engineers who visited Boeing about three days every six weeks, for meetings he arranged. Orders and payments were sent directly to the taxpayer, not to Martinson. The State tax board found that Martinson's activities were necessary in furthering various aspects of the taxpayer's dealings with Boeing. 419 U.S. at 561. Answering the familiar question of "whether the state has given anything for which it can ask return," this Court unanimously said:

[T]he question in the context of the present case verges on the frivolous. For [taxpayer's] employee, Martinson, with a full-time job within the State, made possible the realization and continuance of valuable contractual relations between [the taxpayer] and Boeing.

419 U.S. at 562. Thus, the Court found nexus for imposition of Washington's B&O tax based on market development and maintenance functions, without direct solicitation.

Corresponding nexus is present here. As in *Northwestern States*, TPI's representatives solicit orders and also regularly receive and transmit them to TPI. J.S. B-10 FF 9. Ashe &

Jones transmitted to TPI 55% of its total non-Wade Washington orders. J.A. 162. TPI's representatives also perform the market maintenance functions found sufficient in *Standard Pressed Steel*. They gather and regularly convey to TPI virtually all of TPI's necessary Washington market information. TPI J.S. B-9-10 FF 8. They develop and maintain TPI's Washington market, through "secondary calls" to generate future orders and other activities. TPI J.S. B-10 FF 10. In short, the activities of TPI's representatives involve both the solicitations of the salesmen in *Northwestern States* and the market development and maintenance functions of Martinson in *Standard Pressed Steel*.¹⁹

Whereas *Northwestern States* and *Standard Pressed Steel* support the finding of nexus here, the cases cited by TPI do not refute this conclusion. TPI relies particularly on *Norton*, 340 U.S. 534 (1951). TPI Br. 12-13. However, *Norton* actually found sufficient nexus in the receiving of orders. The Court held that

the judgment attributing to the Chicago branch income from all sales that utilized it either in receiving the orders or distributing the goods was within the realm of permissible judgment. [The taxpayer] has not established that such services as were rendered by the Chicago office were not decisive factors in establishing and holding this market.

340 U.S. at 538 (emphases added). Thus, inasmuch as Ashe & Jones receives and transmits TPI orders, and given the other facts showing that its local services are decisive factors in holding the Washington market, *Norton* compels a nexus finding here.²⁰

¹⁹Given these pervasive local activities undertaken for TPI, we do not rely, as TPI has inferred, on the lesser nexus standard that suffices to impose use tax collection duties. TPI J.S. 13-14. Cf. *National Geographic Society v. California Board of Equalization*, 430 U.S. 551 (1977).

²⁰TPI's recitation of the acts it purportedly does not perform in Washington, TPI Br. 13, ignores the activities which its local representative does perform. For example, TPI claims that it maintained no local office or employees in Washington, TPI Br. 4-5, 13, notwithstanding that Ashe & Jones did so on its behalf. It admits to no local office providing services and handling complaints after a sale, TPI Br. 7, 13, disregarding the finding of fact that sales representatives participate in investigating and handling customer complaints, and the evidence that such contacts with Ashe & Jones occur about 10 to 12 times a year. TPI J.S. B-10 FF 10; J.A. 106. In any event,

TPI may still argue that at least its Utility sales fall into the third category of nontaxable direct sales established in *Norton*, because Ashe & Jones generally did not transmit Utility orders. TPI Br. 13; TPI J.S. 15-16. Even this limited claim must fail in light of the evidence that virtually all of Ashe & Jones' local activities except order-taking were undertaken for both the DWV and Utility departments. See, e.g., TPI J.S. B-9 FF 6; J.A. 48-49, 68, 84-90, 92, 99-103; TPI RP 275-79. In contrast, the majority in *Norton* concluded that the local office did not perform "service helpful to [the taxpayer's] competition for * * * trade" when the goods were ordered and shipped directly from the out-of-state office. 340 U.S. at 536. The *Norton* majority's observation that "no solicitors work the territory," 340 U.S. at 537, also distinguishes the present case, where active solicitors represent the Utility department, make secondary calls and solicit orders for that department, and receive commissions on Utility sales. TPI J.S. B-9 FF 6; TPI Br. 5; J.A. 95, 97, 102-03; TPI RP 245.

3. The contractor status of TPI's agent does not affect nexus.

TPI repeatedly paints the facts as if the local activities of Ashe & Jones were not even before the Court. If that were the case, there concededly would be little basis for a nexus finding under current law. On the other hand, if Ashe & Jones were TPI employees instead of contractors, nexus would be established beyond dispute by *Northwestern States*, 358 U.S. 450 (1959) and *Standard Pressed Steel*, 419 U.S. 560 (1975).

Two considerations compel a conclusion that the requisite nexus also exists here whether contractors or employees are involved. First, as a factual matter, there are no significant differences in how TPI's contractor representatives in Washington and employee representatives elsewhere solicit and process orders or otherwise "call on the trade". TPI J.S. B-11 FF 12.²¹ Second, under this Court's decisions there also is no difference in the tax consequences.

TPI's recitation completely ignores such significant Ashe & Jones activities as market information-gathering and "secondary calls" to generate future orders.

²¹TPI has never disputed this fact, even now in reporting the state court's view of "the sales functions of Ashe & Jones as essentially identical to those of factory salesmen." TPI Br. 13 n. 11.

Scripto, Inc. v. Carson, 362 U.S. 207 (1960) so held, in finding sufficient nexus from the in-state activities of independent contractors to impose use tax collection liability on an out-of-state seller. The Court said that it does not matter for nexus purposes that a taxpayer's "salesmen" are not regular employees devoting full time to its service:

[S]uch a fine distinction is without constitutional significance. The formal shift in the contractual tagging of the salesman as "independent" neither results in changing his local function of solicitation nor bears upon its effectiveness in securing a substantial flow of goods into [the taxing state].

362 U.S. at 211. As this Court further explained, "To permit such formal 'contractual shifts' to make a constitutional difference would open the gates to a stampede of tax avoidance." *Id.*

Since the "contractual tagging of the salesman" is without constitutional significance for a use tax, there is no reason for a different conclusion in the gross receipts context. TPI has never suggested why its own subjective decision to designate sales personnel as contractors rather than employees, without any difference in their functions, should mean different tax consequences. Obviously such an artificial distinction would lead to the same "stampede of tax avoidance" regardless of the type of tax.²²

B. The Selling Tax Is Fairly Related to the Services Provided by the State of Washington.

TPI also argues that the selling tax is not fairly related to services provided by Washington, under the fourth prong of the *Complete Auto* test. This allegedly is because TPI utilized those services to a smaller extent than did a local manufacturer selling in state and it maintained "most (or at least much)" of its "values" in Texas. TPI Br. 18-20.

²²The argument that such a distinction should make a difference in tax consequences was rejected in the gross receipts tax context by *Illinois Commercial Men's Association v. State Board of Equalization*, 34 Cal.3d 839, 671 P.2d 349, 196 Cal.Rptr. 198 (1983), *appeal dism'd*, 466 U.S. 933 (1984). Expressly following *Scripto*, the California Court held that "the circumstance that investigation and/or settlement services" on the taxpayers' behalf "were performed by independent contractors is of little constitutional significance. The undeniable fact is that they were acting as agents" of the taxpayers. 671 P.2d at 355.

This argument is directly refuted by the only case TPI cites in this regard, *Commonwealth Edison*, 453 U.S. 609 (1981). There the taxpayers' complaint was that "the amount the State receives in [severance] taxes far exceeds the value of the services provided to the coal mining industry." 453 U.S. at 621 (emphases by the Court). The Court responded that

there is no requirement under the Due Process Clause that the amount of general revenue taxes collected from a particular activity must be reasonably related to the value of the services provided to the activity. Instead, our consistent rule has been:

* * *

"A tax is not an assessment of benefits. It is, as we have said, a means of distributing the burden of the cost of government. The only benefit to which the taxpayer is constitutionally entitled is that derived from his enjoyment of the privileges of living in an organized society, established and safeguarded by the devotion of taxes to public purposes. * * *"

453 U.S. at 622-23. According to the Court, this latitude afforded the states under the Due Process Clause is not "somehow divested by the Commerce Clause". 453 U.S. at 623.

The Court went on to state this test:

The relevant inquiry under the fourth prong of the *Complete Auto Transit* test is not * * * the amount of the tax or the value of the benefits allegedly bestowed as measured by the costs the State incurs on account of the taxpayer's activities. Rather, the test is closely connected to the first prong of the *Complete Auto Transit* test. Under this threshold test, the interstate business must have a substantial nexus with the State before any tax may be levied on it. * * * Beyond that threshold requirement, the fourth prong of the *Complete Auto Transit* test imposes the additional limitation that the measure of the tax must be reasonably related to the extent of the contact * * * *

453 U.S. at 625-26 (footnotes and citation omitted; emphases by the Court). There, this test was met. "Because it is measured as a percentage of the value of the coal taken, the Montana tax is in 'proper proportion' to [taxpayers'] activities within the State". 453 U.S. at 626.

Washington's tax also manifestly passes this test. As shown above, TPI's business has a substantial nexus with Washington. The measure of the tax is related exactly to the extent of TPI's Washington contact, being a percentage of TPI's gross receipts from Washington sales. *See Standard Pressed Steel*, 419 U.S. 560, 562, 564.

V. IF WASHINGTON'S TAX SYSTEM WERE TO BE INVALIDATED UNDER THE COMMERCE CLAUSE, THE ISSUE OF REMEDY REMAINS.

The decisions reached by the court below upholding Washington's multiple activities exemption are consistent with this Court's opinion in *Armco*, 467 U.S. 638 (1984), which is itself consonant with the Court's earlier decisions. However, the magnitude of tax refund claims requires the State to address remedies in the event that this Court might invalidate Washington's B&O tax, either as to out-of-state manufacturers or Washington manufacturers selling outside the state.²³

A decision invalidating the tax would narrow the latitude the Constitution affords states fashioning their tax systems and would represent a significant departure from the Court's earlier Commerce Clause decisions. Were such a decision rendered, it should be applied prospectively, because it would expressly or by clear implication overrule "clear past precedent" on which the state has relied for the imposition of the tax. *Chevron Oil Co. v. Huson*, 404 U.S. 97, 106-07 (1971).

A. Any Decision Adverse to the State Should Be Given Prospective Effect.

A decision overturning Washington's manufacturing tax would rest either on a holding that manufacturing and selling taxes can never be deemed compensating taxes or on some other constitutional basis foreshadowed no earlier than the Court's opinion in *Armco*, 467 U.S. 638 (1984). A holding on the former grounds would represent a rejection of the Court's longstanding decision in *Hinson*, 8 Wall. 148 (1869) to which no reference was made in *Armco*. A decision invalidating Washington's manufacturing tax on any of the other grounds

²³As NCC has pointed out, NCC J.S. 4, potential tax refunds just for the period through December 31, 1984 approximate \$423 million.

advanced here by The Taxpayers would not have been clearly signaled by any of the Court's opinions preceding *Armco*.²⁴

The tests in *Chevron Oil* for prospective or retrospective application of decisions require the Court to determine whether retrospective application of a rule announced by the decision will promote or interfere with the constitutional interests bound up in the holding. In this regard, the Court has inquired whether retroactive application of its decision would, in actuality, advance the constitutional interests involved. *See, e.g., Lemon v. Kurtzman*, 411 U.S. 192 (1973) (*Lemon II*).

A decision adverse to the state in this case might prohibit the state from imposing its present tax system or require a particular form of apportioned taxation. Either result would not of itself demonstrate that its retrospective application would advance these Commerce Clause interests beyond what the prospective prohibition of the earlier system of taxation can accomplish. A contention that refunds for prior years will further the Commerce Clause's interest in preserving free trade in the future is too speculative. Cf. *Johnson v. New Jersey*, 384 U.S. 719, 728-29 (1966). Moreover, the Court should not require such a refund where The Taxpayers have failed to demonstrate loss from the kind of multiple taxation the Court has heretofore prohibited.

Finally, under the tests laid down in *Chevron Oil* the Court looks at the likelihood of substantial, inequitable results or hardship that may flow from a decision operating retroactively. While the Court may assess the conflicting interests of the parties, significant weight is accorded the good faith reliance of state and local governments on established law, where fiscal matters are involved and there is a need to prevent disruption in the public sector with respect to transactions already concluded. *See, e.g., Cipriano v. Houma*, 395 U.S. 701 (1969).

Washington's selling tax has been continually sustained

²⁴Consistent with the implications in their brief, The Taxpayers have previously argued in this litigation that the Court's opinions in *Maryland v. Louisiana*, 451 U.S. 725 (1981) and *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983) have clearly imperiled Washington's taxes. Only after the Court's decision in *Armco* were this challenge and those of other taxpayers mounted, a fact which sufficiently belies the contention.

by this Court.²⁵ There has been reliance upon the state's manufacturing tax both by public officials and objectively speaking, by taxpayers themselves, following decisions upholding its validity by Washington's highest court, decisions from which no further appeal was taken or heard.²⁶

Hardships that would be entailed by requiring refunds of revenues collected and expended as part of the state's enacted budgets over a period of more than six years are a matter of record.²⁷ As these potential dislocations are weighed, it must be noted once again that The Taxpayers have failed to demonstrate in the record any particularized injury resulting from an aggregation of those types of taxes which the Court has recognized as creating a burden of multiple taxation.

If any decision invalidating Washington's tax is entered, it should, therefore, have only prospective application.

B. This Court's Decisions Prompt Remand to the Court Below for Consideration of Further Issues of Remedy, if the Court Determines Retrospective Effect Is to Be Given to Its Decision.

If this Court were to decide that some retrospective application of a decision adverse to the state would be warranted, the nature of the remedy to be afforded requires resolution of questions which are not before the Court on this appeal. The Taxpayers would not unqualifiedly be entitled to refund sim-

²⁵Standard Pressed Steel, 419 U.S. 560 (1970); General Motors, 377 U.S. 436 (1964). See also the dismissal of an appeal challenging the tax, Chicago Bridge & Iron, 464 U.S. 1013 (1983).

²⁶See *Crown Zellerbach*, 45 Wn.2d 749, 278 P.2d 305 (1954). See also *Crown Zellerbach Corp. v. State*, 53 Wn.2d 813, 328 P.2d 884 (1958), *appeal dism'd*, 359 U.S. 531 (1959). As the Court acknowledged in *Armco*, a case raising an issue similar to that presented here by Washington's manufacturing tax exemption was dismissed in 1982 for want of a substantial federal question. *Columbia Gas Transmission Corp. v. Rose*, 459 U.S. 807 (1982).

²⁷See Affidavit of Daniel Keller, J.A. 210, 215. Based on projections for the state's current 1985-87 biennium, refunds of this magnitude would require an 18% reduction in all programs financed through the state's general fund.

ply by reason of a decision invalidating part or all of the tax in issue here.

In its first session following the Court's decision in *Armco*, 467 U.S. 638 (1984), the Washington legislature enacted a manufacturing business and occupation tax credit for Washington businesses paying gross receipts taxes to other jurisdictions.²⁸

The credit, made provisional upon any decision invalidating Washington's tax, was adopted in the uncertain environment immediately following *Armco* in a straightforward effort by the state to anticipate possible ramifications to Washington's tax system of the Court's discussion of internal consistency. Issues of the credit's application, including any contentions about the validity of the credit itself and The Taxpayers' entitlement to the benefit, are not before this Court and remain to be resolved.

Washington law also contains a comprehensive severability provision as part of its revenue laws.²⁹ This statute would become relevant, should the 1985 credit provision for any reason be found infirm.

The issues arising out of these related features in Washington law were not reached by the court below. They demonstrate the "intertwined" questions of federal constitutional and state law that have prompted the remand of this Court's decisions for subsequent determinations about the application of exemptions or extensions of taxes. *Bacchus*, 468 U.S. 263, 277 (1984); *Hooper v. Bernalillo County Assessor*, 472 U.S. ___, 105 S.Ct. 2862, 2869 (1985). In these situations the courts below have been left with the determination whether an exemption is to be extended or a tax applied.

²⁸Wash. Rev. Code § 82.04.440, 1985 Wash. Laws ch. 190, § 1. The amended section is reproduced in the Appendix.

²⁹Wash. Rev. Code § 82.98.030 is strikingly similar to that found in the savings clause in New York law which occasioned the Court to remand its opinion in *Boston Stock Exchange*, 429 U.S. 318, 337 n. 15 (1977) to the lower court for determination of its application. The text of this section is set out in the Appendix.

CONCLUSION

The judgment of the Washington Supreme Court should be affirmed. However, if the Court overrules some of its prior decisions and invalidates Washington's tax system, the Court should apply its decision prospectively. To the extent the decision is given retrospective application, the case should be remanded for the resolution of questions relating to The Taxpayers' remedy, not before the Court on this appeal.

DATED this 26th day of December, 1986.

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Appendix

Wash. Rev. Code § 82.04.440 Persons taxable on multiple activities. (1) Except as provided in subsections (2) and (3) of this section, every person engaged in activities which are within the purview of the provisions of two or more of sections RCW 82.04.230 to 82.04.290, inclusive, shall be taxable under each paragraph applicable to the activities engaged in.

(2) Persons taxable under RCW 82.04.250 or 82.04.270 shall not be taxable under RCW 82.04.230, 82.04.240, or subsection (2), (3), (4), (5), or (7) of RCW 82.04.260 with respect to extracting or manufacturing of the products so sold.

(3) Persons taxable under RCW 82.04.240 or 82.04.260 subsection (4) shall not be taxable under RCW 82.04.230 with respect to extracting the ingredients of the products so manufactured.

(4)(a) If it is determined by a court of competent jurisdiction, in a judgment not subject to review, that subsection (2) of this section results in an unconstitutional discrimination against interstate or foreign commerce, and that relief is appropriate for any tax reporting periods either before or after April 30, 1985, it is the intent of the legislature that the credit provided in (b) of this subsection shall be applied to such reporting periods and that relief for such periods be limited to the granting of such credit. It is further the intent of the legislature that such credit shall be applicable only under the conditions and to the extent provided in this subsection (4).

(b) As provided in (a) of this subsection, a person taxable under RCW 82.04.230, 82.04.240, or subsection (2), (3), (4), (5), or (7) of RCW 82.04.260 with respect to extracting or manufacturing products in this state shall be allowed a credit against those taxes for any gross receipts taxes paid to another state with respect to the sales of the products so extracted or manufactured in this state. The amount of the credit shall not exceed the tax liability arising under this chapter with respect to the extraction or manufacturing of those products.

(c) For the purpose of this subsection, "gross receipts tax" means a tax:

(i) Which is imposed on or measured by the gross volume of business, in terms of gross receipts or in other terms, and in

the determination of which the deductions allowed would not constitute the tax an income tax or value added tax; and

(ii) Which is also not, pursuant to law or custom, separately stated from the sales price.

(d) For the purpose of this subsection, "state" means state of the United States, any political subdivision thereof, or the District of Columbia, and any foreign country or political subdivision thereof. [As amended by 1985 Wash. Laws ch. 190, § 1.]

Wash. Rev. Code § 82.98.030 Invalidity of part of title not to affect remainder. If any chapter, section, subdivision of a section, paragraph, sentence, clause or word of [Title 82 RCW] for any reason shall be adjudged invalid, such judgment shall not affect, impair or invalidate the remainder of this title but shall be confined in its operation to the chapter, section, subdivision of a section, paragraph, sentence, clause or word of the title directly involved in the controversy in which such judgment shall have been rendered. If any tax imposed under this title shall be adjudged invalid as to any person, corporation, association or class of persons, corporations or associations included within the scope of the general language of this title such invalidity shall not affect the liability of any person, corporation, association or class or persons, corporations, or associations as to which such tax has not been adjudged invalid. It is hereby expressly declared that had any chapter, section, subdivision of a section, paragraph, sentence, clause, word or any person, corporation, association or class of persons, corporations or associations as to which this title is declared invalid been eliminated from the title at the time the same was considered the title would have nevertheless been enacted with such portions eliminated. This section shall not apply to chapter 82.44 RCW.

No. 85-1963

Supreme Court, U.S.
FILED

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IN THE
Supreme Court Of The United States
October Term, 1985

TYLER PIPE INDUSTRIES, INC.,

Appellant

vs.

STATE OF WASHINGTON DEPARTMENT OF REVENUE,

Appellee

On Appeal from the
Supreme Court of Washington

REPLY BRIEF OF APPELLANT

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February 6, 1987

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**On Appeal from the
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REPLY BRIEF OF APPELLANT

February 6, 1987

SUMMARY OF ARGUMENT

The B&O tax is unconstitutional for any one of the following reasons:

- (i) Tyler Pipe's activities in Washington were too minimal to constitute nexus.
- (ii) The B&O tax discriminates against Tyler Pipe, because it allows a tax exemption for local manufacturers only.
- (iii) The tax is not apportioned, because (A) in the tax base Washington recognizes three elements—mining, manufacturing and sales—but fails to reduce the tax when one or more of those elements is conducted out-of-state, and further

because (B) Washington taxes one element—sales—without consideration of what portion of the sales activities were performed out-of-state.

(iv) There is no relation of the tax to Washington services received by Tyler Pipe, because there are no services received.

(v) The tax is not rationally related to the few Tyler Pipe activities in Washington.

I. WASHINGTON MAY NOT IMPOSE ITS B&O TAX UPON TYLER PIPE, BECAUSE WASHINGTON MAKES NO CASE FOR MINIMAL CONNECTION OR SUBSTANTIAL NEXUS.

A. Tyler Pipe's catalog operation does not satisfy the nexus standards.

Washington asserts that Tyler Pipe has sufficient nexus in Washington by reason of (i) sales solicitation and (ii) market maintenance. Wash. Br. 39-40. The few activities cited by Washington are nothing more than order solicitation, and do not account for the extensive selling activities performed by Tyler Pipe in Texas. Following are the principal facts upon which the nexus question involving the DWV Division depends:

A. Activities Performed by Ashe & Jones in Washington:

1. Some sales solicitation.¹

¹The uncontradicted testimony was that the market for Tyler Pipe products is primarily a national one, that the advertising and the contacts with customers are usually made on a national level, that Tyler Pipe is nationally known in the industry, that some of Tyler Pipe's products are unique, and that Tyler Pipe products have a national reputation for high quality. J.A. 24-28, 29-32, 42-44, 59, 66-67, 73-76, 79-80, 96, 105. None of these activities were performed by or attributable to Ashe & Jones. Id.

Other non-Washington sales activities and sources of information used by Tyler Pipe to develop its markets and sales that were specifically
(footnote continued on next page)

2. Market information of a casual nature (gossip).²

B. Activities Performed by Tyler Pipe in Washington:

1. Rare trips of Tyler Pipe employees to Washington.³

C. Services Performed by Tyler Pipe not in Washington:

1. Preparation and distribution of advertising.

2. Extensive market development.

3. Maintenance of inventory.

4. Investigation of credit and acceptance of orders.

5. Delivery of goods by common carrier.

6. Handling of complaints, and replacement of defective parts.

identified as relevant to Washington sales were international, national and regional trade shows and exhibitions, contractors' conventions, trade magazines, industry membership organizations, Tyler Pipe's own sales experiences, and, most importantly, direct telephone conversations with Tyler Pipe's customers (and potential customers). J.A. 25-26, 27-28, 42-43, 51-52, 68-69, 73, 75.

Moreover, the Utility Division made many sales and has even increased its market share in those parts of the country where it utilizes no sales representatives or factory salesmen, J.A. 73-75, 78-79, which suggests either that there are many sources of local information or that local information is not important to the making of sales. Similarly, the DWV Division made international sales despite the fact that it has no overseas representation, J.A. 44, and competitors of Tyler Pipe made sales in Washington without any in-state sales representatives, J.A. 82-84.

²Ashe & Jones was *not* making consumer surveys, conducting market research, running product tests, investigating potential customers, drafting reports or analyses, nor doing anything even remotely approaching market analysis, but was merely and occasionally passing on to Tyler Pipe information that came its way. J.A. 49-52, 57, 68-69, 76, 87-89, 90, 91, 95, 104, 120-121, 147-148, 152-156. The information was not even recorded by Tyler Pipe. J.A. 51, 57.

³Only ten such trips to Washington were made over the 57-month period at issue, including two for the Utility Division (J.A. 65-66), one to attend a regional trade show and one or more for the Wade Division. Interrog. 12-2(c), Exhibit 14.

7. Collections.
8. Financing inventory and receivables.

See Tyler Pipe Br. 3-7; and notes 1 and 2 above.

Washington's statement on pages 37-38 of its brief that in-state solicitation "alone" creates nexus is incorrect. The case Washington cites, *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959), involved out-of-state vendors who maintained employees and offices, plus in one case automobiles, and in the other inventory, in-state. *Id.*, 358 U.S. at 454, 455, 465.

Furthermore, Washington purports to place Tyler Pipe in the taxable category 2 of *Norton Co. v. Illinois*, 340 U.S. 534 (1951), rather than in the nontaxable category 3 of *Norton* where Tyler Pipe belongs (see Tyler P. Br. 13), on the ground that the tax was upheld in *Norton* where Norton's in-state office either *received* the orders or distributed the goods. Wash. Br. 40, citing 340 U.S. at 538. The balance of the paragraph, which Washington failed to quote, makes clear that the orders in category 2 were not merely received, but were *generated* by the Illinois office for products not among the 3,000 Norton items in Norton's local store.⁴ There is no evidence that Ashe & Jones had inventory or a store. See J.A. 97. All Tyler Pipe orders were out of a catalog, all utility orders went directly to Tyler Pipe, and Ashe & Jones telephoned the orders it "received" into Tyler Pipe where the order was actually written up. J.A. 96, 32. If the Court in *Norton* meant "received" to mean nothing more than to serve as a conduit, as Washington asserts, then the Court would have been overruling the solicitation cases. But the Court stated, "[Norton] could have approached the Illinois market through solicitors only and it would have been entitled to the immunity of interstate commerce. . . ." 340 U.S. at 538. Tyler Pipe did just that.

⁴See *Norton Co. v. Department of Revenue* 405 Ill. 314, 90 N.E.2d 737 (1950), where the court found that Norton's activities fell within the category of cases in which orders were completed in state, and distinguished cases where in-state activities involved solicitation only.

Ashe & Jones was an order taker, or more specifically an order transmitter, for Tyler Pipe goods. J.A. 96, 141. Ashe & Jones and the customers had catalogs from which a customer could select the Tyler Pipe products the customer needed. J.A. 29-30, 34, 43, 66-67, 97. Either Ashe & Jones or the wholesaler could telephone the order to Tyler Texas for acceptance and processing.⁵ Tyler Pipe wrote up the order. J.A. 32. The product was shipped F.O.B. Tyler, Texas at the customer's risk. Exhibit 43; J.A. 158. See *National Bellas Hess, Inc. v. Dept. of Revenue*, 386 U.S. 753 (1967).

Tyler Pipe products are bought, not sold. See Exhibit 45, J.A. 157. Customers for plumbing products were builders and plumbing supply contractors, who purchased Tyler Pipe's products only because they were required in a building that was being constructed or to replace leaking pipe. Ashe & Jones did not need to convince a potential customer that he needed pipe, and could not convince a prospective customer to purchase pipe if it was not needed.

Standard Pressed Steel Co. v. Washington, 419 U.S. 560 (1975), upon which Washington places conclusive reliance, is distinguishable because the taxpayer in that case had only one customer in Washington, the Boeing Company, and the taxpayer employed an engineer, Martinson, as a full-time local employee to maintain the customer relationship by performing product design and testing functions. The Court summarized his activities:

[T]he activities of Martinson were necessary to appellant in making it aware of which products Boeing might use, in obtaining the engineering design of those products, in securing the testing of sample products to qualify them for sale to Boeing, in resolving problems of their use after receipt by Boeing, in obtaining and retaining good will and rapport with Boeing personnel, and in keeping the invoicing person-

⁵Orders for 44.96% (including 100% of the Utility Division Orders) of Tyler Pipe's sales did not even go through Ashe & Jones, but went directly from the customer to Tyler Pipe. J.A. 69-72, 162.

nel of appellant up to date on Boeing's list of purchasing specialists or control buyers.

419 U.S. at 561. The seller frequently sent other employees into the state to assist Martinson. 419 U.S. at 561. Martinson & the other employees were not simply soliciting sales. They were integrally involved in the production process from design to testing. Boeing was not ordering stock parts from a catalog, as were Tyler Pipe customers. See Exhibit 45, J.A. 157.

Tyler Pipe's sales representatives were soliciting sales, nothing more. Washington's sweeping statement that Ashe & Jones provided "virtually all" of the "local" market information obtained by Tyler Pipe (Wash. Br. 6.) is patently inaccurate,⁶ and tendentious.

The presence of Tyler Pipe in Washington through Ashe & Jones is far less than was the presence of Norton in nontaxable category 3 (Tyler P. Br., p. 12-13), and is gossamer compared to the presence of Standard Pressed Steel through Martinson.

B. Washington's position on the independent contractor issue is a strawman argument.

The scant solicitation by Ashe & Jones was insufficient to constitute adequate nexus for Tyler Pipe regardless of whether the solicitation was performed by Ashe & Jones or directly by Tyler Pipe. Tyler P. Br. 11-13, and see above. The fact that the activities relied upon by Washington to establish nexus were performed by an independent contractor is relevant only because (1) by misstating the issue Washington seeks to distract the Court from the

⁶The same information was obtained by Tyler Pipe through customers and trade shows. J.A. 68-69. The telephone conversations between Ashe & Jones employees and Tyler Pipe employees were nothing more than solicitors' gossip (J.A. 99); they generated no reports nor analyses; their only importance was that the information was "probably subliminally computed into someone's mind." J.A. 51. See n. 1 and 2, above.

inadequacy of nexus in this case, and (2) the activities of Ashe & Jones were primarily for its own account, and thus subtract from the scant evidence Washington relies upon.

Washington mistakenly poses the nexus question in terms of whether Tyler Pipe can avoid nexus through utilization of an independent contractor rather than an employee. Wash. Br. i (4); Amici Nat'l Gov. Assn. et al. Br. i (3). Washington then states that the difference between employees and independent contractors is an "artificial distinction" (Wash. Br. 42),⁷ citing *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960). First, Tyler Pipe has not asserted that it can avoid nexus through utilization of an independent contractor. Second, in *Scripto*, the Court did not enumerate a sweeping rule of law regarding independent contractors, but stated:

The test is simply the nature and extent of the activities of the appellant [Scripto] in Florida.⁸

⁷The distinction between employees and independent contractors has a long history. See Labatt, *Commentaries on the law of Master and Servant*, 2d Ed. (1913) (eight volumes). Important congressional enactments are dependent upon the distinction. See, e.g., Section 530 of the Revenue Act of 1978, P.L. 95-6, which prohibited the Internal Revenue Service from questioning the status of certain workers as non-employees, and Section 1706 of the Tax Reform Act of 1986, P.L. 99-514, which lifts that ban on computer programmers and other technical employees; *NLRB v. United Insurance Company of America*, 390 U.S. 254 (1968), where the Court applied general agency principles in distinguishing between employees and independent contractors under the National Labor Relations Act; *Spirides v. Reinhardt*, 613 F.2d 826 (D.C. Cir. 1979), where the Court recognized that independent contractors were not (as were employees) covered by Title VII of the Civil Rights Act of 1964, as amended by the Equal Employment Opportunity Act of 1972; and the Federal Interstate Income Tax Act, 15 U.S.C. §§ 381 to 384.

⁸*Scripto* is also distinguishable, because *Scripto* involved only the issue of whether there was sufficient presence to justify requiring an out-of-state person "to collect" a use tax imposed upon in-state buyers, not to pay a tax, and the out-of-state person was reimbursed for those services that were required by the State. The Washington B&O tax, by its

(Footnote continued on following page)

Washington thus makes an erroneous factual assumption, states an erroneous rule of law, and, not surprisingly, reaches the erroneous conclusion that there is nexus in this case.

Tyler Pipe asserts only that the activities of an independent contractor must be analyzed to determine what portion of a local independent contractor's activities is his, and what portion is the out-of-state supplier's, to determine whether an out-of-state person has adequate presence to constitute nexus.⁹ See Tyler P. Br. 10 *et seq.* and A-4 *et seq.*

Ashe & Jones has been in business longer than Tyler Pipe. J.A. 95, 23-24. Ashe & Jones maintained an office from which it solicited for Ashe & Jones' six or seven suppliers. J.A. 100, 109. This activity constituted Ashe & Jones' presence, not Tyler Pipe's presence, in Washington. The customers were those of Ashe & Jones. See J.A. 106, 109. If Ashe & Jones were to terminate its relationship with Tyler Pipe, Ashe & Jones would still have its place of business, and plumbing supply customers who

(Footnote continued from previous page)

express terms, does not fall upon the Washington buyer, but upon the out-of-state seller. R.C.W. 82.04.500, J.S. G-5. The Court has distinguished between taxes whose burden falls upon interstate sellers and those whose burden falls upon local buyers, holding that the former must satisfy more rigorous Constitutional standards than the latter. Cf. *McLeod v. J.E. Dilworth Co.*, 322 U.S. 327 (1944) (holding that a sales tax falling upon an interstate seller was unconstitutional under the Commerce Clause) with *General Trading Co. v. State Tax Comm'n of Iowa*, 322 U.S. 335 (1944) (holding that a use tax falling upon the local buyer was constitutional under the Commerce Clause); also, *Norton, supra* at 537. The Court has established lower standards for imposition of the duty to collect use taxes because such taxes do not run the risk of double taxation, the determination of the taxability of a sale is "self-evident", and "the sole burden imposed upon the out-of-state seller . . . is the administrative one of collecting [the tax]." *National Geographic Society v. California Board of Equalization*, 430 U.S. 551, 558 (1977).

The Court's treatment of this issue will be important in its effect on the franchise industry, such as fast-food restaurants, and on tiny manufacturers who market through national distributors, such as electronics distributors.

appeared at Ashe & Jones' office would simply have been handed a new and different catalog for DWV products.

Ashe & Jones had 3.5 salespersons representing six or seven manufacturers. J.A. 100, 102, 109. Even if the sales people spent 100% of the time on sales (but see J.A. 103), and Tyler Pipe received a pro rata share of their time, which seems doubtful for a catalog operation, then the time allocated to Tyler Pipe would have been the equivalent of only one-half of a sales person.

Ashe & Jones was compensated only through commissions on sales actually made. J.A. 18. Contrary to Washington's statement (Wash. Br. 5), employees working in the sales department of Tyler Pipe were paid salaries, plus commissions. They also participated in Tyler Pipe's employee benefit plans.¹⁰ The commission arrangement with Ashe & Jones was designed to generate sales, nothing more. Ashe & Jones was not paid to do marketing.

Tyler Pipe could not tell Ashe & Jones to do anything.¹¹ Tyler Pipe's employees are required to do whatever they are told to do within the general scope of their employment (Restatement, Second, Agency, Ch. 13, § 385), which included a long list of items involved in sales and marketing that Ashe & Jones was not paid to do. See p. 2-4, above.¹²

¹⁰Unlike the sales representatives, the employees of Tyler Pipe are subsidized by Tyler Pipe in their cost of doing business, are compensated by Tyler Pipe on a mixed salary and commission basis, are provided insurance benefits by Tyler Pipe, and are under the immediate and day-to-day control and supervision of Tyler Pipe. J.A. 57, 60-61, 89, 122-123; and see J.A. 94, 106, 109, 111-112.

¹¹Ashe & Jones might do what it was "asked" (Wash. Br. 5; J.A. 90), but that would only be to preserve the relationship that generated commissions for Ashe & Jones. See J.A. 106, 109, 111.

¹²The statement of Washington that Tyler Pipe "directed, supervised, and instructed" Ashe & Jones (Wash. Br. 5) is directly contrary to

(Footnote continued on following page)

When the nature and extent of the activities of Ashe & Jones is analyzed, it is clear that the activities were principally for the benefit of Ashe & Jones and cannot be viewed as Tyler Pipe presence.

Apparently, the Washington legislature recognized the significance in the difference between an independent contractor and an employee. The B&O tax was imposed upon Ashe & Jones on the commissions it received from Tyler Pipe, but would not have been imposed upon wages paid to Tyler Pipe employees, if any had lived in Washington. R.C.W. § 82.04.360, p. A-1 below. The form and substance of the relationship has a substantial bearing on the tax at issue in this case.¹³

II. WASHINGTON CANNOT IMPOSE ITS B&O TAX UPON TYLER PIPE, BECAUSE THE WASHINGTON B&O TAX (A) DISCRIMINATES AGAINST INTER-STATE COMMERCE, (B) IS NOT FAIRLY APPORTIONED, (C) IS NOT FAIRLY RELATED TO THE SERVICES PROVIDED BY THE STATE OF WASHINGTON, AND (D) LACKS A RATIONAL RELATIONSHIP BETWEEN THE INCOME OF TYLER PIPE THAT WASHINGTON SEEKS TO TAX AND THE INTRA-STATE VALUES OF TYLER PIPE.

(Footnote continued from previous page)

all the evidence. See Tyler P. Br. 5-7. The job descriptions cited by Washington (J.A. 131-132, 134) refer to the direction, supervision and instruction of employee salesmen. Similarly, Washington's description of Ashe & Jones as Tyler Pipe's "agent" (Wash. Br. 5) distorts the evidence. J.A. 33-36, 153; and see J.A. 110.

¹³When a seller does not enter a state, but sells through local independent representatives, the state may tax the representatives' commissions based upon their local activities, but may not tax the seller whose goods were sold. *Ficklen v. Taxing District of Shelby County*, 145 U.S. 1 (1892); cf. *Robbins v. Taxing District of Shelby County*, 120 U.S. 489 (1887); and see *Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434, 440 (1939).

A. The B&O tax discriminates.

- (1) Washington relies on sales and severance tax cases that do not apply to gross receipts taxes.

Washington asserts that the wholesaling element of its B&O tax is akin to a sales tax and the manufacturing element is akin to a severance tax. E.g., Wash. Br. 12, 20, 23, 27, 28, 31-32, 34, 35-36; and see *Amici Nat'l Gov. Assn. et al. Br.* 2, 23 and 25. The B&O tax, however, is distinguishable from a sales tax because the burden of the B&O tax does not fall on the Washington buyer, see n.8 above, and is distinguishable from a severance tax because it is not a tax on property ownership, see *Exxon Corp. v. Wisc. Dept. of Revenue*, 447 U.S. 207, 228 (1980). The B&O tax law itself explicitly states:

It is not the intention of this chapter that the taxes herein levied upon persons engaging in business be construed as taxes upon purchasers or customers, but that such taxes shall be levied upon, and collectible from, the person engaging in the business activities herein designated and that such taxes shall constitute a part of the operating overhead of such persons.

R.C.W. § 82.04.500, J.S., G-5; and see, *Norton, supra* at 537; *General Motors Corporation v. Washington*, 377 U.S. 375, 440 (1964).

- (2) The B&O tax is not tax-neutral, because it encourages businesses to move to Washington.

The applicable constitutional test for non-discrimination is "tax neutral decision-making". That, the State of Washington acknowledges. Wash. Br. 23. Washington's assertion, however, that the B&O tax is neutral because an out-of-state seller pays exactly the same tax as a local seller is fallacious, because the local seller is exempt from the taxes of other states to which the out-of-state seller is subject. The B&O tax does not allow "tax neutral decision-making" because Tyler Pipe, by relocating part of its manufacturing operations to Washington, could reduce its

tax burden in the State of Texas without incurring additional Washington B&O tax.

B. The B&O tax is not fairly apportioned.

- (1) The B&O tax does not reflect the fact that most of Tyler Pipe's selling activities and all of its manufacturing activities take place out-of-state.

The B&O Tax is not apportioned because it purports to tax an entire mining-manufacturing-sales business, but it fails to apportion the tax where one or more of those activities, mining and/or manufacturing, for example is performed out-of-state. Even if Washington were to tax each of the three elements performed in-state, the tax would not be fairly apportioned as to the sale element, because some—in Tyler Pipe's case the vast majority (Tyler P. Br. 4-5; p. 3-4, above)—of the post-manufacturing activities generating the gross receipts tax are performed out-of-state, and Washington makes no attempt to apportion that element of the tax. See *Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434, 439-440 (1939). Washington's reliance on *Standard Pressed Steel* is misplaced because there all of the activities being taxed were performed in-state. See 419 U.S. at 564.

- (2) Having imposed the B&O tax on the commissions paid to Ashe & Jones, Washington seeks to tax the same transaction twice.

A portion of Tyler Pipe's Washington gross receipts are paid to Ashe & Jones, and taxed by Washington, as commissions.¹⁴ In view of the minimum level of activities of Tyler Pipe directly and through Ashe & Jones (p. 2-6, above), Washington has already taxed a sufficient portion of Tyler Pipe's gross receipts from its

¹⁴These commissions are subject to the Washington B&O Tax at a higher rate than would be applied to Tyler Pipe's total Washington gross receipts: 1.00 percent versus 0.44 percent, R.C.W. § 82.04.270 and 82.04.290, J.S. G-4 and G-5, or (in years subsequent to those involved in this case) 1.50 percent versus 0.484 percent, see pages E-6 and E-7 of the Jurisdictional Statement in *National Can Corp. v. Department of Revenue*, No. 85-2006.

Washington sales and has not shown why this de facto apportionment should be altered.

C. The tax is not fairly related to the services allegedly received by Tyler Pipe, because Tyler Pipe received no services from Washington.

Washington asserts that Tyler Pipe receives from the State of Washington (i) police protection, (ii) fire protection, (iii) availability of the courts and (iv) numerous other advantages of a civilized society. Wash. Br. p. 4.

Police protection is of no relevance to Tyler Pipe in the string of activities performed by Tyler Pipe to complete a sale. See p. 3-4, above. Protection of Ashe & Jones and its employees is not within the scope of Tyler Pipe's responsibility, a substantive difference between operating through a legitimate independent contractor and an employee.

Fire protection is of no relevance to Tyler Pipe because Tyler Pipe has no property in Washington.

The only occasion Tyler Pipe has used a court in Washington is in this case.

Tyler Pipe has no employees in Washington¹⁵ to enjoy the numerous other advantages of Washington's civilized society.

If the B&O tax is held to be fairly related to the virtually non-existent services that Washington asserts it provides to Tyler Pipe, in what case would the element of fair relation have any meaning? See *Armco, Inc. v. Hardesty*, 467 U.S. 638, 104 S. Ct. 2620, 2623, n. 6.

If the fair-relation-to-services test is nothing more than the nexus test, as Washington argues (Wash. Br. 13, 44), the fact that Tyler Pipe receives no Washington services for itself or its employees is further evidence of the want of nexus in this case.

¹⁵Washington does not even assert that Tyler Pipe enjoys "the benefit of a trained work force." *Exxon, supra* at 228.

D. The B&O tax lacks rational relationship to the intrastate values of Tyler Pipe, because Tyler Pipe's values are located in Texas.

Virtually none of the value of Tyler Pipe's products is added in Washington, yet Washington, in assuming that there is minimal connection, essentially argues that nothing more is required in order for Washington to tax all of Tyler Pipe's gross receipts from Washington, Wash. Br. 43-44, thus arguing rational relationship out of the Due Process Clause requirement.

III. WASHINGTON MAY NOT RAISE A NEW ARGUMENT NOW. EVEN IF TYLER PIPE WERE ONLY A SELLER, AND NOT ALSO A MANUFACTURER, THE B&O TAX IS UNCONSTITUTIONAL AS APPLIED TO TYLER PIPE BECAUSE WASHINGTON SEEKS TO MAKE TYLER PIPE BEAR THE FULL TAX BURDEN OF AN IN-STATE MANUFACTURER/SELLER.

Washington argues that Tyler Pipe can not raise the discrimination issue, because the products sold by Tyler Pipe were manufactured by Tyler Pipe's wholly-owned subsidiaries. Wash Br. 20-21, 37, n. 16.

The Washington Supreme Court refused to hear that argument, because Washington raised it for the first time in the appeal to that court. J.S. A-9. See, *Bass, Ratcliff & Gretton v. State Tax Commission*, 266 U.S. 271, 284-285 (1924).

At the trial, the parties, the witnesses and both counsel treated Tyler Pipe and its wholly-owned manufacturing subsidiaries as a unitary operation (e.g., J.A. 14, 46, 48, 52, 81, 83, 88, 94, 100, 106, 112, 114, 139), even though the State knew from the outset that the products at issue were manufactured by a subsidiary. J.A. 4, 17, 135, 139, 140.

Had Washington timely raised its argument, Tyler Pipe would have shown that the sale of products by the subsidiaries of Tyler

Pipe was strictly by book entries, that Ashe & Jones was in fact the representative of the manufacturing operation (Exhibit 41, J.A. 152), and that this would be an appropriate case to disregard the separate entities, as was in fact done at the trial.

IV. THERE IS NO NEED FOR REMAND.

- A. Contrary to the assertion of Washington, Tyler Pipe has been advocating its position since before the Court's decision in *Armco*.**
- B. Even if the *Armco* decision is to be applied prospectively only, Tyler Pipe is entitled to a tax refund inasmuch as Tyler Pipe pursued its arguments prior to *Armco*.**

Contrary to what Washington states, Wash. Br. 45, n. 24, Tyler Pipe first raised constitutional questions at the administrative level on February 25, 1981, and briefed the discrimination issue, citing *Maryland v. Louisiana*, 451 U.S. 725 (1981), among other cases, before the trial court in November of 1983. The Court decided *Armco* on June 12, 1984.

Prospective application of the Court's ruling under these circumstances would frustrate the purposes of the Commerce Clause and of the Due Process Clause and would be especially inequitable to litigants, such as Tyler Pipe, who have pursued their constitutional rights at great cost and inconvenience prior to the alleged emergence of an "unforeshadowed" constitutional doctrine. *Chevron Oil Company v. Huson*, 404 U.S. 97, 106-107 (1971); and see *U.S. v. Johnson*, 457 U.S. 537, 562 (1982).

Washington does not assert the need for remand if the Court holds for Tyler Pipe on any of the nexus, apportionment, relation to services or rational relation issues.

- C. The so-called "credit" remedy enacted by Washington is meaningless.**

Remand to consider the purported remedy to credit taxpayers for gross receipts taxes paid in other states is meaningless,

because, as Amici National Governors' Association, et. al. state (Amici Br. 2, 18), no other State currently imposes a gross receipts tax. Washington ignores the fact that the multiple tax burden borne by out-of-state sellers is often in the form of income and franchise taxes. The purported "remedy" is nothing more than an attempt to subject out-of-state sellers to needless protracted litigation and to deny them their tax refunds.

CONCLUSION

The State of Washington

- (i) cannot convert Tyler Pipe's catalog operation into local presence;
- (ii) cannot mask the independent contractor question by misstating the issue;
- (iii) cannot avoid the discrimination issue by isolating the State of Washington from the rest of the country;
- (iv) cannot satisfy the apportionment requirement by taxing a minor portion of a sale the same as the whole sale;
- (v) cannot tax Tyler Pipe for services it does not receive;
- (vi) cannot raise new issues after the trial; and
- (vii) cannot keep the taxes it has collected by enacting retroactive, hollow remedies.

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APPENDIX

Revised Code of Washington:

82.04.360

Exemptions—Employees

This chapter shall not apply to any person in respect to his employment in the capacity of an employee or servant as distinguished from that of an independent contractor.

(1) (6)

Supreme Court, U.S.
FILED

NOV 20 1986

JOSEPH F. SPANIOL, JR.
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No. 85-2006 and No. 85-1963

IN THE
Supreme Court of the United States
OCTOBER TERM, 1986

NATIONAL CAN CORPORATION, *et al.*,
v. *Appellants*,

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,
Appellee.

TYLER PIPE INDUSTRIES, INC.,
v. *Appellant,*

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,
Appellee.

On Appeal from the
Supreme Court of the State of Washington

**BRIEF OF THE COMMITTEE ON STATE TAXATION
OF THE COUNCIL OF STATE CHAMBERS
OF COMMERCE AS *AMICUS CURIAE*
IN SUPPORT OF APPELLANTS**

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QUESTION PRESENTED

Whether a state's gross receipts tax system which imposes a tax on manufacturing and on selling activities but exempts from taxation the manufacturing activities of purely local manufacturer-sellers impermissibly discriminates against interstate commerce in violation of the Commerce Clause of the United States Constitution?

(i)

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1986

No. 85-2006

NATIONAL CAN CORPORATION, *et al.*,
v. *Appellants*,STATE OF WASHINGTON, DEPARTMENT OF REVENUE,
Appellee.

No. 85-1963

TYLER PIPE INDUSTRIES, INC.,
v. *Appellant*,STATE OF WASHINGTON, DEPARTMENT OF REVENUE,
Appellee.On Appeal from the
Supreme Court of the State of WashingtonBRIEF OF THE COMMITTEE ON STATE TAXATION
OF THE COUNCIL OF STATE CHAMBERS
OF COMMERCE AS *AMICUS CURIAE*
IN SUPPORT OF APPELLANTS

INTRODUCTORY STATEMENT

This brief is submitted by the Committee on State Taxation of the Council of State Chambers of Commerce as *amicus curiae* in support of the Appellants in the

above-captioned cases. Written consents of the Appellants and the Appellee have been obtained and are attached herewith.

INTEREST OF AMICUS CURIAE

The Council of State Chambers of Commerce (COUNCIL), organized in 1932, consists of 41 Chambers of Commerce. The Committee on State Taxation (COST), one of the three advisory committees of the COUNCIL, consists of 249 corporate members which conduct a substantial portion of the interstate commerce of United States taxpayers. One of COST's principal activities has been to work with the states and others toward developing fair and equitable standards of state taxation.

Member companies of COST are representative of that part of the Nation's business sector which is most directly affected by state taxation of interstate operations. COST is, therefore, vitally interested in cases such as this one which present issues significantly affecting state and local taxation of interstate commerce.

Member companies of COST conduct business in Washington, West Virginia and Indiana, and in many local taxing jurisdictions, such as Los Angeles and Philadelphia—all of which have gross receipts tax systems. This Court in *Armco, Inc. v. Hardesty*, 467 U.S. 638 (1984), made clear that, in determining the validity of a state's gross receipts tax under the Commerce Clause, the principle of "internal consistency" applies. Under this rule, a state tax must have an internal consistency such that, if the challenged tax were applied by every jurisdiction, there would be no impermissible interference with interstate commerce.

Washington's gross receipts tax at issue in this case is the mirror image of the West Virginia taxing system declared unconstitutional in the *Armco* case. Like West Virginia, Washington imposes a gross receipts tax on the

privilege of manufacturing within the state. Wash. Rev. Code § 82.04.240. Similarly, Washington also imposes a gross receipts tax on companies engaged in the business of selling at wholesale and at retail. Wash. Rev. Code §§ 82.04.270 & 82.04.250. The Washington "multiple activities" exemption is the reverse of that found in the West Virginia tax scheme, exempting wholly intrastate businesses from the manufacturing tax instead of the selling tax. Washington manufacturer-sellers, who are taxed as wholesalers or retailers, are exempt from taxation as manufacturers. Wash. Rev. Code § 82.04.440.

The discriminatory effect in this case is identical to that found by the Court in *Armco*. Both gross receipts tax systems lack internal consistency. If the precise tax scheme of each state were projected into other states, as was shown in *Armco*, interstate manufacturer-wholesalers would be subjected to two gross receipts taxes while wholly intrastate manufacturer-wholesalers are assured of being subjected to only one such tax. The West Virginia tax system invalidated in *Armco* and the Washington taxing scheme here at issue both discriminate against interstate commerce in favor of wholly local, intrastate commerce. If the Washington Supreme Court had applied the "internal consistency" test prescribed by the Court in *Armco*, it would have been equally clear that the Washington gross receipts tax scheme is also unconstitutionally discriminatory under the Commerce Clause. The Washington Supreme Court, however, held that the Washington tax does not discriminate against interstate commerce, choosing to disregard the Court's decision in *Armco* as controlling precedent and relying instead on earlier cases in which the state's gross receipts tax withstood various commerce clause challenges because it was "unable to find . . . a command in the *Armco* decision" to "disregard earlier decisions not overruled." 105 Wash. 2d at 332.

Appellant interstate businesses in the "test case" before this Court, *National Can Corporation, et al. v. State of Washington, Department of Revenue*, No. 85-2006, are representative of more than 100 taxpayers engaging in interstate commerce who filed substantially similar actions in reliance upon the Court's decision in *Armco*. The critical issue in all these cases is whether Washington's application of its Business and Occupation Tax, a gross receipts tax functionally indistinguishable from the West Virginia tax invalidated in *Armco* because it subjected interstate commerce to an unfair burden of multiple taxation not borne by local commerce, impermissibly discriminates against interstate commerce.

The decision of the Washington Supreme Court, in its disregard of the "internal consistency" test for establishing constitutionally impermissible multiple taxation burdens upon interstate commerce, is in irreconcilable conflict with this Court's decision in *Armco* and is inconsistent with prior rulings by this Court striking down discriminatory state taxes under the Commerce Clause. This case is indistinguishable from *Armco* and the conflicting decision below threatens to disrupt the current progress by the states toward assuring a reasonably consistent and fair system of taxation throughout the nation which will (1) allow each state to receive its just share of the total tax contribution of the nation's business sector, (2) prevent inequity and (3) protect the Constitutional rights of interstate corporate taxpayers.

SUMMARY OF ARGUMENT

A state's gross receipts tax scheme which subjects an interstate manufacturer-seller to multiple taxation not borne by a local wholly intrastate competitor constitutes an impermissible discrimination against interstate commerce in violation of the Commerce Clause of the United States Constitution.

ARGUMENT

THE WASHINGTON B&O TAX OPERATES DISCRIMINATORILY TO IMPOSE A BURDEN ON INTERSTATE COMMERCE NOT BORNE BY INTRASTATE COMMERCE

In *Armco, Inc. v. Hardesty*, 467 U.S. 638 (1984), this Court held that West Virginia's wholesale gross receipts tax, from which local manufacturers were exempt, unconstitutionally discriminated against interstate commerce notwithstanding that local manufacturers making sales in the state were subject to a much higher manufacturing gross receipts tax. The West Virginia tax was found to be facially discriminatory because two companies selling tangible property at wholesale in West Virginia would be treated differently depending on whether the taxpayer conducted manufacturing in the state or out of it. The discriminatory effect on interstate commerce in favor of wholly local intrastate commerce was further demonstrated when the state's precise tax system was projected into other states:

"If Ohio or any of the other 48 States imposes a like tax on its manufacturers—which they have every right to do—then Armco and others from out of state will pay both a manufacturing tax and a wholesale tax while sellers resident in West Virginia will pay only the manufacturing tax." 467 U.S. at 644.

This Court in *Armco* specifically rejected the view that actual discrimination against interstate commerce must be shown and adopted the principle of "internal consistency" in determining the validity of a state's gross receipts tax under the Commerce Clause:

"Appellee suggests that we should require Armco to prove actual discriminatory impact on it by pointing to a State that imposes a manufacturing tax that results in a total burden higher than that imposed on Armco's competitors in West Virginia. This is

Business Occupation Tax law contains anti-discriminatory language in Washington since the Washington state legislature local competitors' right must be protected.

on Waukesha residents to sales lists to let it know if they are eligible for tax relief.

and gross sales receipts and Massachusetts would levy a tax on manufacturers who exact a manufacturer's tax on sales to Massachusetts customers. The state of Illinois as well as Massachusetts would be subject to two taxes on manufacturers in a state having the same taxation provided otherwise is also true. Out-of-state consumers manufactured to pay a manufacturer's tax and a selling tax. The rule would then provide that state would be subject to manufacturer commerce who manufacturers in Massachusetts were in effect in other jurisdictions' companies engaged in interstate trade to "allow" them to do so. It the Massachusetts tax allows states to meet the general commercial case words, the gross receipts tax imposed by the

to small tax would depend on the "spurious" constitutionality of the tax itself. The Court noted that the other side's argument was that the tax was unconstitutional because it imposed a tax on the exercise of a constitutional right.

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West Virginia tax on its inter-state sales was imposed by the state legislature in 1921. The tax was levied on all sales made in West Virginia, except those made by manufacturers and importers. The tax was imposed to provide revenue for the state's general fund. It was also intended to encourage the manufacture of goods within the state. The tax was imposed at a rate of 2% on all sales made in West Virginia.

ELIMINATION AGAINST INTERSTATE COMMERCE.

Finally, it is with the same intent to insure the widest possible distribution of information that the Bureau has issued a circular letter to all State and local authorities, and to the heads of the various departments of the Federal Government, calling their attention to the importance of the new law and the steps which should be taken to give it effect.

The Washington Supreme Court in dismissing its appeal states: "See W.S. 102 at ——."

by the court below:

"internal consistency," test of "macro" was acknowledged by
international commerce during unconstitutional periods. The
central tax system in this case, identical to the one used on

The strong mitigation effect of the *W* allele is likely to have a discriminative effect on the *W* allele.

Waste management fees are collected by local governments. The fees are used to fund waste management activities such as collection, transport, treatment, and disposal. The amount of the fee varies by location and may be based on factors such as the type of waste generated or the size of the household.

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Keşfettiler yaradılmıştır.

*W*hich receives a large number of visitors from all over the world, and makes a great impression upon them.

CONCLUSION

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Supreme Court, U.S.
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IN THE
Supreme Court of the United States

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NATIONAL CAN CORPORATION, *et al.*,
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Appellee.

On Appeal from the Supreme Court of Washington

BRIEF OF THE
NATIONAL GOVERNORS' ASSOCIATION,
NATIONAL LEAGUE OF CITIES,
NATIONAL ASSOCIATION OF COUNTIES,
INTERNATIONAL CITY MANAGEMENT ASSOCIATION,
NATIONAL CONFERENCE OF STATE LEGISLATURES,
AND U.S. CONFERENCE OF MAYORS
AS *AMICI CURIAE* IN SUPPORT OF APPELLEE

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QUESTIONS PRESENTED

1. Whether Washington's gross receipts tax on manufacturing and wholesaling activities within the State discriminates against interstate commerce, in violation of the Commerce Clause, because a local manufacturer-seller that pays the wholesale tax is protected from double taxation by an exemption from the manufacturing tax.
2. Whether the Commerce Clause precludes the imposition of any gross receipts tax, given that gross receipts, used as a measure of the tax base, may include value derived from activities in other States.
3. Whether either the Commerce Clause or the Due Process Clause precludes Washington from taxing an out-of-state manufacturer that engages in regular, substantial business activity in the State through independent sales representatives rather than employees.

(i)

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1986

Nos. 85-1963 and 85-2006

TYLER PIPE INDUSTRIES, INC.,
v.
*Appellant,*STATE OF WASHINGTON DEPARTMENT OF REVENUE,
v.
*Appellee.*NATIONAL CAN CORPORATION, *et al.*,
v.
*Appellants,*STATE OF WASHINGTON DEPARTMENT OF REVENUE,
v.
Appellee.

On Appeal from the Supreme Court of Washington

**BRIEF OF THE
NATIONAL GOVERNORS' ASSOCIATION,
NATIONAL LEAGUE OF CITIES,
NATIONAL ASSOCIATION OF COUNTIES,
INTERNATIONAL CITY MANAGEMENT ASSOCIATION,
NATIONAL CONFERENCE OF STATE LEGISLATURES,
AND U.S. CONFERENCE OF MAYORS
AS AMICI CURIAE IN SUPPORT OF APPELLEE**

INTEREST OF THE AMICI CURIAE

The *amici*, organizations whose members include state, county, and municipal governments and officials throughout the United States, have a compelling interest in legal issues that affect state and local governments. This case concerns the constitutionality of a business and occupation tax imposed by the State of Washington on busi-

nesses that manufacture or sell goods at wholesale in the State. If this Court accepts the arguments raised against the tax, the State has estimated that the actual and projected potential tax refund liability will exceed \$423 million, exclusive of interest. J.A. 205. In addition, because a gross receipts tax is a kind of sales tax,¹ the case has significant potential to affect the ability of state and local governments to impose sales taxes on national businesses. Since 1944, the general retail sales tax has been the most important tax source of state government.²

Since this Court's decision in *Armco Inc. v. Hardesty*, 467 U.S. 638 (1984), invalidating a West Virginia tax, Washington has been the only State that imposes a general business and occupation tax. Washington imposes no income tax, choosing instead to raise the revenue necessary to fund essential state functions and other governmental programs from the business and occupation tax, as well as a sales tax. *Amici* are concerned that invalidation of the tax challenged in this case will severely limit the policy choices constitutionally available to state and local governments in formulating tax policy and, in particular, will require Washington to overhaul its entire tax structure. The power to raise revenue by imposing taxes is the essence of sovereignty; and the States, as sovereigns in our constitutional system of government, "possess an independent and uncontrollable authority to raise their own revenues for the supply of their own wants." *The Federalist No. 32*, at 198 (A. Hamilton) (Mentor ed.

¹ J. Hellerstein & W. Hellerstein, *Cases and Materials on State and Local Taxation* 551 (4th ed. 1978).

² Forty-five States and the District of Columbia currently impose sales taxes, which account for 32% of their tax collections. In addition, as of October 1984, local sales taxes were imposed in 26 States. About 6,400 local governments annually collect \$12.6 billion, an average of 10.2% of 1984 tax revenues. In some cities, however, sales taxes account for 60% of revenue. J. Aronson & J. Hillyer, *Financing State and Local Governments* 94 (4th ed. 1986) (citing Census Bureau data).

1961). In our view, the Constitution requires the widest possible latitude for state and local taxes and the exceedingly sparing application of federal preemption under the Commerce Clause or the Due Process Clause.

As a Nation, we have come to another turning point in the balance of power and responsibilities between the federal government and state and local governments. For years, the federal government has appropriated an increasing share of the national income; but the reciprocity previously provided through revenue sharing has been abandoned, and grants-in-aid have been severely reduced. Adding even further to the financial burden on state and local governments is Congress's increasing reliance on state and local budgets to pay for social service programs and benefits previously funded by the federal government. The struggle of state and local governments for economic solvency and self-sufficiency cannot be successful if the limited tax base available to state and local governments continues to be eroded through federal preemption. Increasingly, national businesses are asserting federal preemption of state and local taxes to avoid paying their fair share for the protection and the benefits that government provides. *E.g., R.J. Reynolds Tobacco Co. v. Durham County, N.C.*, Nos. 85-1021, 1022 (U.S. Dec. 9, 1986); *Wardair Canada, Inc. v. Florida Department of Revenue*, 106 S.Ct. 2369 (1986); *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983). Such preemption not only imposes an unfair burden on other taxpayers but undermines the State's ability to govern because, quite simply, government services and benefits cost money. *Amici* therefore urge the Court to reaffirm the standards developed in its recent cases: state taxes are not invalid under the Supremacy Clause unless a finding of conflict with constitutional principles or with federal law is clearly and unavoidably compelled.

Amici submit that the decisions of the Washington Supreme Court are correct. Because this Court's decision will have a direct effect on matters of prime importance

to *amici* and their members, *amici* submit this brief to assist the Court in its resolution of the case.³

STATEMENT OF THE CASE

Amici adopt appellee's statement of the case and emphasize the following points. The appellant corporations each conduct at least part of their business within the State of Washington. They challenge the constitutionality of Washington's levy of its business and occupation ("B & O") tax. The B & O tax is assessed for the "act or privilege of engaging in business activities" in the State of Washington and is levied against the value of all products manufactured or sold at wholesale in the State. Wash. Rev. Code § 82.04.220. The tax imposed is a percentage (0.44%) of the gross receipts derived from the sale of the products.

The tax, levied uniformly on all intrastate or interstate businesses that manufacture or wholesale products in Washington, contains a "multiple activities exemption," applicable to a business that both manufactures and sells its product within the State. Wash. Rev. Code § 82.04.440. That business is exempt from the manufacturing tax on the product because it pays the wholesale tax on the same product.

None of the appellants pays a gross receipts tax on manufacturing or wholesaling to any other State. Appellants challenge the B & O tax on the ground that it discriminates against interstate businesses and is not fairly apportioned to the activities performed in Washington.

Appellant Tyler Pipe also challenges the B & O tax on the ground that the company does not have sufficient "nexus" to the State of Washington to be subject to a

³ Pursuant to Rule 36 of the Rules of this Court, the parties have consented to the filing of this brief. Their letters of consent have been filed with the Clerk of the Court.

state tax there. Tyler Pipe solicits substantial sales and provides services to its customers in Washington through exclusive sales agents who are independent contractors, rather than employees of the company. Although these agents perform services functionally equivalent to those performed by direct employees of other companies, Tyler Pipe argues that their status as independent contractors creates a shield insulating it from tax liability.

SUMMARY OF ARGUMENT

This Court properly refuses to strike down a state tax as unconstitutional absent a clear and convincing showing that it has an unlawful effect. This restraint recognizes the essential power that States retain under our federal system to raise revenue by taxation so that they may provide the services and other attributes of a civilized society. The Court has invalidated state taxes under the Commerce Clause only when they conferred a direct benefit on local business and when the litigant challenging a tax has demonstrated that it suffers an actual adverse impact.

The recent decision in *Armco Inc. v. Hardesty*, 467 U.S. 638 (1984), on its facts, merely stands for the proposition that a state tax is unconstitutional if it facially discriminates against interstate commerce. Yet appellants, relying on *dicta* in *Armco*, would extend its holding to facially neutral taxes on the basis of hypothetical discrimination. This departure from settled law is particularly disturbing because it ignores not only the traditional principles applicable to state tax challenges, but also the concept that a litigant must establish injury in fact to confer Article III standing. This Court should reject appellants' efforts to expand *Armco*.

When Washington's B & O tax is judged by traditional standards, it is clear, as this Court has held on three previous occasions, that it passes constitutional muster. The tax treats interstate and intrastate businesses equally and allows them to make tax-neutral decisions. In short, it does not discriminate against interstate commerce.

Appellants are no more successful on their fair apportionment claim. Appellants have not shown that the tax is out of all proportion to the business conducted in the State, which is the apportionment standard applicable to state taxation of interstate businesses. Appellants can show at most an incidental burden of multiple taxation, stemming from a partial overlap in the measures of various taxes imposed by other States. Any such overlap, however, results not from any infirmity in Washington's tax, but merely because Washington's tax differs from those of its neighbors. Washington is entitled to apportion its gross receipts taxes by allocation and is not required to use an apportionment formula appropriate to income taxes. Washington's allocation taxes a business exactly in proportion to its activity in the State.

Finally, appellant Tyler Pipe's suggestion that a business can avoid its fair burden of state taxation by relying on independent contractors rather than employees to solicit sales and to service clients must be rejected out of hand. Tyler Pipe's substantial business in Washington enjoys the services and benefits conferred by the State; whether it does so through direct employees or independent contractors has no constitutional significance.

ARGUMENT

I. THE POWER TO TAX IS AT THE CORE OF STATE SOVEREIGNTY, AND THE STATES ARE ENTITLED TO SUBSTANTIAL DISCRETION IN DESIGNING THEIR TAX SYSTEMS.

Appellants broadly challenge the specific tax scheme enacted by the State of Washington. Appellants' challenge is fueled in great part by *dicta* in this Court's recent opinion in *Armco Inc. v. Hardesty*, 467 U.S. 638 (1984). Certain language in *Armco* represents a dramatic departure from prior decisions judging the validity of state tax systems. As we explain more fully in Part II, *Armco* is not controlling here. But we also urge this Court to recognize that the broad *dicta* in *Armco* are not

consistent with the respect that the Court traditionally shows for state tax schemes, reflecting its appreciation of the fundamental relationship between the power to tax and the existence of vital state governments. In brief, the Court has repeatedly recognized that (1) the power to tax to raise revenue is an essential attribute of state sovereignty, (2) the Constitution does not require uniformity among the States as to the type of taxes imposed, and (3) the choice of a particular tax system is by its nature legislative. These principles, more fully discussed below, should inform this Court's analysis, and, when applied to this case, demonstrate the constitutionality of Washington's tax scheme.

A. The Power To Tax Is An Essential Attribute Of State Power.

The power to impose taxes is an inherent attribute of state sovereignty. The States "possess an independent and uncontrollable authority to raise their own revenues for the supply of their own wants." *The Federalist No. 32*, at 198 (A. Hamilton) (Mentor ed. 1961). Taxing authority is essential if States are to provide services and the other features of a "civilized society" to their citizens and to those businesses, both intrastate and interstate, that choose to conduct business within a State's borders. See *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207, 228 (1980); see also *Union Pacific Railroad v. Peniston*, 85 U.S. (18 Wall.) 5, 33 (1873) (without the power to tax, "it is manifest the state governments would be paralyzed").

Accordingly, constitutional limitations on a State's power to tax must be construed in light of the very real needs of the State to raise revenue (*id.* at 30-31):

It cannot be that a State tax which remotely affects the efficient exercise of a Federal power is for that reason alone inhibited by the Constitution. To hold that would be to deny to the States all power to tax persons or property The States are, and they must ever be, coexistent with the National govern-

ment. Neither may destroy the other. Hence the Federal Constitution must receive a practical construction. Its limitations and its implied prohibitions must not be extended so far as to destroy the necessary powers of the States, or prevent their efficient exercise.

A "practical construction" of the Constitution confers upon the States substantial discretion in levying taxes; limitations imposed by the Commerce Clause or the Due Process Clause should be sparingly applied only to the most compelling cases of clear constitutional violation. *See Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 622 (1981) ("This Court has indicated that States have considerable latitude in imposing general revenue taxes.").

B. The Choice Of A Tax Scheme Is An Exercise Of Legislative, Not Judicial, Prerogative.

Appellants broadly attack the constitutionality of Washington's B & O tax, a gross receipts tax adopted as a general revenue device. Although a State's power to tax is limited by the Commerce Clause, this Court has steadfastly refused to substitute its judgment for that of the state legislature as to the propriety of any particular tax system. The Constitution is neutral with respect to a preference for any particular kind of tax. *See Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 279 (1978). In *Moorman*, this Court was faced with a challenge to an income tax scheme that was unique among the States. The "asserted constitutional flaw" of the challenged tax was that "it is different from that presently employed by a majority of States and that difference creates a risk of duplicative taxation." *Id.* at 278. If that characteristic itself made the tax unconstitutional, only a uniform rule for state income taxes, imposed by the Court, could have overcome the infirmity. This the Court refused to do. "Although the adoption of a uniform code would undeniably advance the policies that underlie the Commerce Clause, it would require a policy decision based on political and economic considerations that vary from State to State." *Id.* at 279. Accordingly, Washington's B & O

tax is not infirm solely to the ground of its uniqueness and the consequent difficulty in making it fit neatly with the varying tax structures of other States.

The Court should be particularly reluctant to strike down Washington's B & O tax because it represents the "longstanding tax policy" of the State. *See Moorman Manufacturing*, 437 U.S. at 280 n.16. Washington has levied a B & O tax since 1953 and has never levied a personal or corporate income tax, the only serious alternative to a gross receipts tax. In fact, the State Supreme Court has held that a corporate income tax is unconstitutional under the uniformity clause of the state constitution. *See Power, Inc. v. Huntley*, 39 Wn.2d 191, 235 P.2d 173 (1951). As an expression of the political will of the people of the State of Washington, the choice of a B & O tax should be respected by this Court.

An adverse decision on the apportionment issue in this case may well preclude any gross receipts taxes, notwithstanding this Court's repeated judgment that the tax is constitutional.⁴ Appellants argue that Washington must apportion part of the manufacturing value or wholesale price of a product to activity in other States. But a gross receipts tax is a tax on *gross receipts*, i.e., all of a business' receipts within the taxing jurisdiction. Accordingly, a holding that Washington may not constitutionally tax all of the gross receipts of manufacturing or wholesaling activity within the State is essentially a holding that no gross receipts tax may ever be imposed.

An adverse decision on the discrimination issue may also force Washington to abandon its gross receipts tax system. The discrimination challenge is based on the multiple activities exemption, which protects local manufacturer-sellers from double taxation by exempting them

⁴ *General Motors Corp. v. Washington*, 377 U.S. 436 (1964); *Standard Pressed Steel Co. v. Washington Department of Revenue*, 419 U.S. 560 (1975); *Chicago Bridge & Iron Co. v. Washington Dep't of Revenue*, 98 Wn.2d 814, 659 P.2d 463, appeal dismissed, 464 U.S. 1013 (1983).

from paying the manufacturing tax on the same goods on which they have paid the wholesale tax.⁵ As we discuss more fully below (pp. 16-17), the multiple activities exemption serves two essential purposes: to prevent discrimination *against* local business, and fairly to "encourage the growth and development of intrastate commerce and industry" (*see Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 336 (1977)). A decision that Washington must impose a double gross receipts tax on its local manufacturer-wholesalers would leave the State with only two choices: either adopt taxing policies that are plainly harmful to the economic future of the State, or abandon its strongly held political consensus against income taxation. This is a choice that Washington should not have to make.

II. WASHINGTON'S GROSS RECEIPTS TAXES ON MANUFACTURING AND WHOLESALING DO NOT DISCRIMINATE AGAINST INTERSTATE COMMERCE.

The constitutional test for the validity of a state tax is found in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977), which held that a tax is valid under the Commerce Clause if it "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce,

⁵ In an attempt to protect the source of the essential revenue collected through the B & O tax, the Washington state legislature, after this Court's decision in *Armco*, enacted a contingent tax credit available to companies that manufacture out of the State, to go into effect if there were a judicial decision that the multiple activities exemption discriminated against interstate commerce. The credit would be available to out-of-state manufacturers against Washington's wholesaling tax for amounts paid as gross receipts taxes on manufacturing in other States. Wash. Rev. Code § 82.04.440(4). Appellants' claims of discrimination, however, are not limited to the failure of the current tax scheme to provide the credit contained in this fallback provision. Should the Court accept any of these broader arguments, the fallback provision might not be sufficient to sustain the multiple activities exemption, which is integral to Washington's gross receipts tax system.

and is fairly related to the services provided by the State." Appellants National Can, *et al.*, rest their argument primarily on the contention that Washington's gross receipts taxes on manufacturing and wholesaling discriminate against interstate commerce. Appellants also challenge the fair apportionment prong of the test. Appellant Tyler Pipe challenges the nexus, fair apportionment, and discrimination prongs of the test.

A. *Armco* Is Not Controlling In This Case.

All the appellants rest their discrimination claims primarily upon the Court's opinion in *Armco*. But *Armco* is not controlling here. *Armco* stands only for the proposition that a state tax that facially discriminates against interstate commerce is invalid. The issue in *Armco*, as the Court noted, was whether "West Virginia's wholesale gross receipts tax, *from which local manufacturers are exempt*, unconstitutionally discriminates against interstate commerce." 467 U.S. at 639 (emphasis supplied). The Court found that it did. *Id.* at 642. West Virginia sought to overcome this facial discrimination by arguing that the wholesale tax was a constitutionally acceptable equivalent for the State's manufacturing tax, which was not assessed against out-of-state businesses. *Ibid.* The Court rejected this argument because of differences in the rates and the bases of the two taxes. *Id.* at 643.

Having rejected West Virginia's only defense to the facial discrimination of the wholesaling tax, the Court need not have gone any further; and had the opinion stopped there, the discrimination challenge in this case might well not be before the Court. This Court has repeatedly upheld the Washington gross receipts tax, and none of the discussion of facial discrimination aids appellants, who in fact do not rely on the holding of *Armco*. Appellants' challenge arises only because the *Armco* opinion contains certain generalized assumptions and broad conclusions regarding the validity of state tax schemes. These statements, which were not necessary to dispose of the case, are properly regarded as *dicta* and

therefore not controlling precedent. *See R.J. Reynolds Tobacco Co. v. Durham County, N.C.*, Nos. 85-1021, 1022 (U.S. Dec. 9, 1986); *Cohens v. Virginia*, 19 U.S. (6 Wheat.) 264, 399 (1821). They should, in particular, be treated as noncontrolling *dicta* because they represent such serious departures from the Court's prior cases. In at least three respects, the *Armco* opinion breaks with the Court's long-standing approach to discrimination claims.

First, the Court did not evaluate the combined effect of the West Virginia manufacturing and wholesale taxes, and thus did not consider the actual effect of the State's tax system on *Armco*. In fact, as a practical matter, the tax scheme imposed a substantially higher tax rate on an in-state manufacturer than on an out-of-state wholesaler. But the Court explicitly stated that it would not require *Armco* to prove "actual discriminatory impact on it." 467 U.S. at 644. This approach departs from the established test that unconstitutional discrimination means actual discrimination against interstate commerce in the form of a direct commercial advantage to local business. *See Boston Stock Exchange*, 429 U.S. at 329.

Second, and more important, for the first time ever, the Court judged the West Virginia tax system solely on the basis of hypothetical discrimination arising from the interplay of that system with taxes that *could be* (but in fact were not) imposed by *other States*. The Court never found, and could not find on the record before it, that the West Virginia tax system had an actual discriminatory impact on interstate commerce. As Justice (now Chief Justice) Rehnquist noted in dissent, the impact of West Virginia's system as a whole fell more heavily on intra-state than on interstate commerce. 467 U.S. at 647. The discriminatory impact was found only by reference to hypothetical taxes that other States might impose. Prior cases, however, demand that state taxes challenged under the Commerce Clause be judged by their "practical operation" (*Best & Co. v. Maxwell*, 311 U.S. 454, 456 (1940))

or "actuality of operation" (*Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64, 69 (1963)).⁶

Third, the Court employed, also for the first time, the principle of "internal consistency" as a test for unconstitutional discrimination. Although the Court had previously announced the internal consistency standard as a measure of the fair apportionment of a state income tax (*see Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983)), no case had suggested that the internal consistency principle was relevant in determining whether a state tax was discriminatory.

There are strong reasons why the *Armco dicta* should not be deemed controlling in this or any other case. Foremost is that the application of a "hypothetical discrimination" test is completely at odds with the constitutional prerequisites for standing imposed by the "cases and controversies" requirement of Article III, § 2 of the Constitution. *See, e.g., Valley Forge Christian College v. Americans United*, 454 U.S. 464, 471-72 (1982). One of the fundamental requirements for standing is a showing of "some actual or threatened injury" to the plaintiff. *Ibid.* "Abstract injury is not enough" (*City of Los Angeles v. Lyons*, 461 U.S. 95, 101 (1983)), and standing is not conferred as a result of a "conjectural" or "hypothetical" injury. *Id.* at 102.

The actual injury requirement should defeat jurisdiction of a claim based solely upon the taxpayer's ability to

⁶ In *Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434 (1939), the Court invalidated a Washington gross receipts tax that was not fairly apportioned to activities within the State. *See id.* at 439. The Court did not require a showing of actual discrimination through multiple taxation, but found that the absence of fair apportionment was itself sufficient to invalidate the tax. The Court did not hold that a fairly apportioned tax could be struck down without any showing of actual discrimination against interstate commerce. The current Washington gross receipts taxing system is fairly apportioned, as we show below (pp. 21-25); and, therefore, nothing in *Gwin, White* suggests that it is invalid.

imagine a tax in another State which, in combination with the challenged tax, might result in discrimination against an interstate business. The Court has consistently applied rigorous standing requirements to taxpayer suits. See *Valley Forge; Flast v. Cohen*, 392 U.S. 83 (1968). To be sure, appellants have an economic, rather than political or social, stake in the outcome of this case: they would like to avoid some or all of their tax obligations to the State of Washington. Nevertheless, a claim of a hypothetical tax burden is simply not a case or controversy involving the "actual or threatened injury" required under Article III.

If appellants' claims are addressed, this Court's recent opinion in *R.J. Reynolds Tobacco Co. v. Durham County, N.C.*, Nos. 85-1021, 1022 (U.S. Dec. 9, 1986), indicates the appropriate course. *Reynolds* disposed of a similar challenge to a state tax based on *dictum* in a previous opinion, *Xerox Corp. v. Harris County, Texas*, 459 U.S. 145 (1982), which had suggested that any state property tax imposed on imported goods stored in customs bonded warehouses was invalid. In *Reynolds*, the Court unanimously upheld a state tax imposed on goods imported and stored for domestic use, easily limiting *Xerox* to its facts and its narrow holding, which concerned only goods stored for re-export. We urge the Court in this case similarly to separate the facts and the holding of *Armco* from its *dicta*. The West Virginia wholesaling tax under review in that case was found to discriminate on its face against interstate business. The Washington tax at issue here does not. When the *dicta* in *Armco* are stripped away, as *Reynolds* teaches, Washington's tax clearly passes constitutional muster. This Court has so held on three prior occasions. See note 4, *supra*.

B. Washington's Wholesaling Tax Does Not Discriminate Against Interstate Commerce.

The actual holding in *Armco* provides no support for appellants' challenge to the wholesaling tax because *Armco* held only that a facially discriminatory tax vio-

lated the Commerce Clause. The Washington wholesaling tax is not discriminatory on its face or in its operation. Every wholesaler in the State pays a wholesaling gross receipts tax of 0.44%. The tax applies equally to wholesalers who manufacture within the State and wholesalers who manufacture outside the State. Every wholesaler is treated the same as every other wholesaler.

Appellants' argument that the Washington wholesaling tax nevertheless violates the Commerce Clause relies on *Maryland v. Louisiana*, 451 U.S. 725 (1981). National Can Br. 7-8; Tyler Pipe Br. 16-17. In *Maryland*, a number of States and pipeline companies challenged Louisiana's first-use tax as applied to natural gas brought into Louisiana from the Outer Continental Shelf ("OCS"). *Id.* at 728. Louisiana imposed an equivalent severance tax on natural gas produced within the State. *Id.* at 731. Three aspects of the first-use tax favored local interests and discriminated against interstate commerce. First, there was an exemption from the tax for OCS gas used for certain purposes within Louisiana but not outside Louisiana. Second, a full credit against the first-use tax was given to producers of gas in Louisiana but not to producers in other States. Third, other tax credits had the effect of shielding Louisiana consumers, but not consumers in other States, from the impact of the tax. On these bases, the Court held that Louisiana's first-use tax was protectionist legislation; it was found to impose as much tax as possible on producers and consumers outside the State and as little tax as possible on producers and consumers within the State. *Id.* at 757, 758.

The only element of the Louisiana first-use tax scheme that bears any resemblance to the Washington wholesaling tax is the credit that was given to producers of OCS gas who also produced gas subject to the Louisiana severance tax. Appellants argue that this credit is similar in effect to Washington's multiple activities exemption, available to local manufacturers if they pay the wholesaling tax. But that exemption differs radically from Loui-

siana's first-use tax credit, which was granted for local economic activity *unrelated* to production of OCS gas. Thus, an OCS gas producer with unrelated production in Louisiana gained a "direct commercial advantage" over an otherwise identical OCS gas producer having no other production in Louisiana. The tax scheme therefore could be said to discriminate against out-of-state companies.

Washington's multiple activities exemption grants no "direct commercial advantage" to a local manufacturer. It does not reward a business for engaging in other economic activity in Washington. All goods are subject to the same rate of tax; both interstate and intrastate businesses are treated neutrally. In fact, the effect of the Washington multiple activities exemption is precisely the opposite of Louisiana's first-use tax credit. The exemption *equalizes* tax burdens placed on goods manufactured in Washington and goods manufactured elsewhere, by ensuring that an item manufactured and sold in Washington will not be subject to a *greater* tax burden than the same item sold in Washington but manufactured elsewhere.

The multiple activities exemption serves two essential purposes. First, the exemption prevents discrimination *against* local business. Without the exemption, local manufacturers that sell their products in the State would pay two gross receipts taxes (one for manufacturing and one for wholesaling), while out-of-state manufacturers selling in the state would pay one gross receipts tax (for wholesaling). In the real world, and contrary to the purely hypothetical situations postulated by appellants, no other State imposes a gross receipts tax on manufacturing. Thus, without the multiple activities exemption, local manufacturers would be disadvantaged in competing with out-of-state manufacturers for sales within the State.

The second essential purpose of the multiple activities exemption, consistently recognized as legitimate for a state tax system, is fairly to "encourage the growth and development of intrastate commerce and industry." *Bos-*

ton Stock Exchange, 429 U.S. at 336. In *Boston Stock Exchange*, the Court expressly recognized the validity of "two activities for the price of one" encouragement. While striking down a facially discriminatory amendment to a state tax, the Court approved the State's previous law (*id.* at 330); that law imposed a tax if any one of five taxable events occurred within the State, but if more than one taxable event occurred in the State, only one tax was payable (*id.* at 322). Washington's gross receipts tax does just the same.

For these reasons, the Washington wholesaling tax does not discriminate against interstate commerce. The statute on its face applies to all wholesaling within the State, and the exemption from the manufacturing tax granted to in-state manufacturers merely ensures that no goods will be taxed twice. The tax is a model of a neutral tax that affects all businesses equally. Neither *Maryland v. Louisiana* nor any other decision of this Court supports the invalidation of such a tax under the Commerce Clause.

C. The Application Of The Washington Manufacturing Tax Solely To Local Manufacturers Selling Outside The State Does Not Discriminate Against Out-Of-State Manufacturers Selling Within The State.

In challenging the Washington wholesale gross receipts tax as discriminatory, appellants seem to recognize that this tax applies to all sellers without exception. Yet Xerox and others argue that the application of the manufacturing tax to local manufacturers only when they sell outside the State somehow makes discriminatory the tax imposed on the selling activity of out-of-state manufacturers. Stated another way, they argue that because local manufacturers who sell their products in the State are exempt from the manufacturing tax, the selling tax is discriminatory as applied to out-of-state manufacturers. This argument is without merit for several reasons. Whether viewed by itself or as part of the entire gross receipts tax

scheme, the manufacturing tax is discriminatory neither on its face nor in its effect on out-of-state manufacturers.

First, the manufacturing tax applies identically to in-state and out-of-state manufacturers selling goods in Washington. Neither group pays any manufacturing tax. In-state manufacturers are exempt from the manufacturing tax under the multiple activities exemption, and out-of-state manufacturers are not subject to the tax. In addition, because in-state and out-of-state manufacturers are subject to the same rate of wholesaling tax in Washington, their overall state tax burden is the same.

The record is barren of any evidence that any other State imposes a gross receipts tax on manufacturing. Thus, none of the out-of-state manufacturers selling in the State can be said to pay any higher taxes than a local manufacturer-seller. Because the "actuality of operation" of the Washington tax system does not discriminate against any of the appellants, none of them has standing to challenge the tax.⁷

In any event, Washington's wholesaling gross receipts tax would not be invalid even if another State imposed a manufacturing gross receipts tax, and a manufacturer in that State selling in Washington were thus subject to a greater total tax burden than a Washington manufacturer. Whether Washington provides an exemption for in-state manufacturers should be of no concern to an out-of-state manufacturer because it is not subject to the manufacturing tax either. As applied to out-of-state manufacturers, Washington's system is the same as one that taxes only wholesaling.

⁷ To the extent that *dicta* in *Armco* would excuse a showing of "actual discrimination," it should either be read in the light of the fact confronting the Court in that case, i.e., a statute that was facially discriminatory, or disregarded in favor of the decades of precedent examining the actual operation of challenged state taxes. See discussion *supra*, at pp. 11-14.

In *Armco*, the Court described precisely this type of tax as permissible under the Commerce Clause. The Court stated (467 U.S. at 645):

It is true, as the State of Washington appearing as *amicus curiae* points out, that *Armco* would be faced with the same situation that it complains of here if Ohio (or some other state) imposed a tax only upon manufacturing, while West Virginia imposed a tax only upon wholesaling. In that situation, *Armco* would bear two taxes, while West Virginia sellers would bear only one. But such a result would not arise from impermissible discrimination against interstate commerce, but from fair encouragement of in-state business.

Thus, the claim that the exemption of Washington wholesalers from the *manufacturing* tax makes discriminatory the application of the *wholesaling* tax to out-of-state manufacturers lacks merit, even if they are subject to a manufacturing tax in another state.

D. The Washington Manufacturing Tax Does Not Discriminate Against Local Manufacturers Selling Out Of The State.

A number of appellants represented by Kalama manufacture in Washington products that they sell outside the State. This group claims that Washington's manufacturing tax discriminates against them because they have to pay the tax while local manufacturers who sell their products in-state are exempt.

This argument finds no support in *Armco*, because, in *Armco*, all West Virginia manufacturers paid the same tax regardless of where they sold their products. *Maryland v. Louisiana* also offers no comfort to these appellants because it did not involve a challenge to a manufacturing tax on any products originating in Louisiana. The tax was imposed on a product brought *into* Louisiana from the Outer Continental Shelf, and its effect was to allow a product to be sold in Louisiana at a lower price

than the same product could be sold in other States. *Maryland*, 451 U.S. at 756. The Washington statute works no such discrimination. To the contrary, it is designed merely to equalize the impact of the gross receipts tax on all manufactured goods. Goods manufactured in Washington and shipped elsewhere bear a tax burden of 0.44% when they leave the State; if they are sold to a consumer in the State, they bear the same 0.44% tax when they leave the stream of commerce in Washington. Although the exporter pays the manufacturing tax, and the local seller pays the wholesaling tax, the *dollar* tax burden on each is identical. Thus, the Washington tax system does not enable a consumer in Washington to purchase manufactured goods at a lower price than a consumer of the same goods in another State.

The exemption of local wholesalers from the manufacturing tax is necessary to avoid unfair treatment of local business. If Washington imposed gross receipts taxes on both the local manufacture and the local sale of products, its consumers would have a clear economic incentive to travel to neighboring States to purchase goods. Similar economic consequences, resulting from the imposition of a retail sales tax on goods sold in the State without a compensating use tax on goods brought into the State, have led the States to impose compensating use taxes, long upheld by this Court. See *Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937). Washington's multiple activities exemption is the obverse of the same coin; like a compensating use tax, it treats out-of-state and domestic goods equally in order to avoid incentives to residents to make purchases in other States.⁸

The Washington gross receipts taxing system must be viewed in its entirety, just as this Court viewed the

⁸ Such "[e]qual treatment of interstate commerce . . . has been the common theme running through the cases in which this Court has sustained 'compensating,' state use taxes." *Boston Stock Exchange*, 429 U.S. at 331.

Washington sales and use tax system in *Henneford*. So viewed, it represents the State's attempt to achieve equality in the treatment of all goods manufactured or sold at wholesale in Washington. The multiple activities exemption is a necessary element of that equality. Without that exemption, local business would suffer an actual discrimination measurable in dollars and cents. With the exemption, interstate commerce suffers neither actual nor meaningful hypothetical discrimination.

Finally, appellants contend that the Washington taxing scheme is flawed because it provides an incentive for businesses to move into the State of Washington to avoid paying both the hypothetical manufacturing tax in the other State and the actual wholesaling tax in Washington. Even if such an incentive existed, however, it would provide no basis for invalidating a state tax under the Commerce Clause. In *Boston Stock Exchange* (429 U.S. at 336-37) and again in *Armco* (467 U.S. at 642), this Court made it clear that so long as a State does not engage in "impermissible discrimination against interstate commerce," it is free to use its taxing system to encourage the growth or relocation of business within the State. Because Washington's taxing system does not so discriminate, any incentive that it may provide for businesses to relocate to Washington is of no constitutional significance.

III. WASHINGTON'S TAX IS APPORTIONED EXACTLY TO THE ACTIVITIES TAXED.

A. The B & O Tax Does Not Result In Multiple Taxation.

Appellants assert that the Washington tax is invalid because it is not fairly apportioned. This argument rests solely on claims of multiple taxation. See Brief of Amici Amcord, et al. ("Amcord"), adopted in National Can Br. 17. But it is clear that, in the context of interstate commerce, the risk of multiple taxation cannot, in and of itself, be the basis for invalidating a state tax. Moreover, Amcord ignores the distinction between a gross receipts tax (such as the B & O) and an income-based tax. As a

consequence, Amcord misstates the tax burden that may constitutionally be imposed on interstate commerce and urges the application of an improper apportionment test.

In *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983), the Court held that the test for the validity of state taxes imposed on interstate businesses, like appellants, is not whether a tax may result in multiple taxation, but whether the "taxpayer can prove 'by clear and cogent evidence'" that the tax "is in fact 'out of all appropriate proportions to the business transacted . . . in that state.'" *Id.* at 169-70 (quoting *Moorman Manufacturing Co.*, 437 U.S. at 274, and *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123, 135 (1931)).⁹ Accordingly, appellants' and Amcord's claims of multiple taxation must fail because, quite simply, they have not established by clear and convincing evidence a tax wholly out of proportion to their activities in Washington.

Rather than meet this test, appellants and Amcord offer a simplistic and superficial argument. They contend that because Washington's tax is assessed against 100% of the gross receipts from the sale of goods, it is a tax on their full value, and therefore constitutes multiple taxation if any other State imposes a tax based on the value of the same goods.¹⁰ Thus, National Can contends that it is exposed to multiple taxation because it is subject to a California income tax that uses a base including the

⁹ *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 451 (1979), which concerned a state tax on foreign commerce, is irrelevant here.

¹⁰ Appellants' argument proves far too much. Their focus on whether the full value of the goods is subject to tax in Washington would seem to render vulnerable even a retail sales tax on any product subject to a gross receipts tax or included in the gross receipts used as the measure of an income tax. The State of destination may constitutionally impose a sales tax (*see, e.g., State Tax Comm'n v. Pacific States Cast Iron Pipe Co.*, 372 U.S. 605 (1963)); and the Court has never suggested that its validity depends on whether it results in the cumulative taxation of more than 100% of the value of the goods.

gross receipts of all sales, including those in Washington. Similarly, Kalama contends that it is subject to multiple taxation because it is subject to an income tax in Illinois based on the proceeds of the sale in that State of goods that it manufactures in Washington.

Washington's gross receipts tax is so different from other States' income taxes that unlawful multiple taxation cannot result. The B & O tax does not use the same measurement of value as an income tax—one taxes the value of doing business in a State, the other the value of the income produced. The two systems are no more comparable than apples and oranges. This Court has often recognized the varying effects and incidents of different kinds of taxes that tax different values, and has upheld the application of state taxes against the claim that they posed a risk of multiple taxation in violation of the Commerce Clause.

In *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207, 228 n.12 (1980), the Court distinguished a severance tax from an income tax, and upheld the application of the state apportionment formula to net income from oil and gas production even though producing States might impose a severance tax on the gross value of the mineral extracted or the quantity of production. The B & O tax at issue here is very similar to a severance tax, which has in fact been likened to an occupation tax (*ibid.*); both measure the tax against gross value rather than net income. *Ibid.* Thus, the B & O tax can be imposed without regard to any state income taxes to which appellants may be subject.

Similarly, in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980), the Court distinguished an *ad valorem* property tax from an income tax, noting that "[t]axation by apportionment and taxation by allocation to a single situs are theoretically incommensurate . . ." *Id.* at 444. Thus, the Court upheld the application of Vermont's income tax to an apportioned share of dividend income even on the assumption that New York, as the

State of commercial domicile, could impose an unapportioned tax on those dividends. The Court noted simply that Vermont's tax was constitutional because the State sought to tax income, not ownership. *Id.* at 444-46.

These cases make clear that different types of state taxation do not present even the risk of multiple taxation. In some cases, the Court has gone further, upholding state taxes even if they produced actual multiple taxation. In *Moorman Manufacturing Co.*, the Court rejected the claim that "the Commerce Clause prohibits any overlap in the computation of taxable income by the States." 437 U.S. at 278. Thus, Iowa's tax was upheld in spite of the Court's recognition that the State's apportionment of its tax base resulted in multiple taxation. *See also Container Corp.*, *supra* (upholding the tax at issue even though it resulted in actual double taxation).¹¹

As noted above, there is no showing in this case of any actual multiple taxation. Thus, the Court need go no further than to recognize, as it has done repeatedly, that the imposition of different types of state taxes creates not even a risk of multiple taxation. Unless the Court is now prepared to prefer as a matter of constitutional law one system over another, it should not invalidate a state tax system merely because it may present the risk of multiple taxation by being "different from the . . . practice of [a] neighbor." *Moorman Manufacturing*, 437 U.S. at 280 n.16.

B. Washington Is Entitled To Apportion By Allocation.

Appellants' and Amcord's apportionment challenge rests on application of the income tax apportionment test. Because of the differences, noted above, between a gross receipts tax and an income tax, the imposition of a formula appropriate to an income tax would invalidate

¹¹ If multiple taxation resulting from different tax schemes presents a significant obstacle to interstate commerce, the conflict is appropriate for resolution by congressional legislation or through interstate compacts. *See Commonwealth Edison*, 453 U.S. at 628.

any gross receipts tax. Washington's tax should be upheld if it is "apportioned to its activities within the state." *Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434, 439 (1939) (quoted in *Standard Pressed Steel Co. v. Washington Department of Revenue*, 419 U.S. 560, 564 (1975)). As this Court concluded in *Standard Pressed Steel*, the Washington tax meets this test.

A gross receipts tax by definition taxes the value of 100% of the receipts of the taxed activity (e.g., manufacturing or wholesaling) and should not be held invalid merely because it does so. It is invalid only if levied against activities that occur outside of the State. In other words, the gross receipts tax must be "fairly related to the services rendered by [the State], which include police and fire protection, the benefit of a trained work force, and the 'advantages of a civilized society.'" *Exxon Corp.*, 447 U.S. at 228.

The challenged tax here is levied solely at activities occurring within the State of Washington and "is 'apportioned exactly to the activities taxed,' all of which are intrastate." *Standard Pressed Steel*, 419 U.S. at 564. Washington taxes manufacturing within the State and sales at wholesale within the State. Amcord's argument (Br. 9) that goods sold at wholesale in Washington may have received "value" in another State is irrelevant because Washington's wholesaling tax is not a tax on "value added" but a tax on the privilege of engaging in business within the State.¹² This Court has firmly rejected the notion that the Commerce Clause prohibits a tax on the aspects of interstate commerce occurring within a State. *See Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). That is all that the Washington B & O tax reaches.

¹² Because a gross receipts tax is a type of sales tax (J. Hellerstein & W. Hellerstein, *op. cit.* 551), formula apportionment is no more appropriate for a gross receipts tax than for a retail sales tax. *See Standard Pressed Steel*, 419 U.S. at 564.

IV. TYLER PIPE HAS A SUFFICIENT NEXUS TO WASHINGTON TO JUSTIFY APPLICATION OF WASHINGTON'S TAXES TO IT.

Appellant Tyler Pipe raises an argument not pursued by the other appellants—that there is an insufficient “nexus” between Tyler Pipe and the State of Washington to justify the imposition of the gross receipts tax on its sales within the State. (See Br. 10-13). The existence of a “substantial nexus” with the taxing State is part of the Commerce Clause test set out in *Complete Auto Transit*, 430 U.S. at 279. Tyler Pipe also contends that there is not a “minimal connection” between its activities and the State of Washington sufficient to support the Washington tax against the limitations imposed by the Due Process Clause. As Tyler Pipe recognizes (Br. 11), the two tests are similar. *See, e.g., Exxon Corp.*, 447 U.S. at 228 (equating the due process nexus requirement with the Commerce Clause test). Both arguments rest primarily on the fact that Tyler Pipe maintains no office in Washington and fills orders directly from its Texas headquarters.

Tyler Pipe’s sales in Washington are solicited by independent sales representatives rather than through its own employees. These representatives “handle all sales functions pertaining to [Tyler Pipe’s] products in [the] state” and receive a commission on all sales made in their territory even if the customer contacts Tyler Pipe directly. J.S. App. in 85-1963, B-9. The representatives “maintain and improve [its] name recognition, market share, goodwill, and individual customer relations” and transmit to Tyler Pipe “[v]irtually all [the] information” concerning the Washington market that is “necessary to keeping [it] competitive in the marketplace.” *Id.* at B-9 to B-10.

There is no question that, if the activities of Tyler Pipe’s sales representatives were performed instead by employees, the “substantial nexus” and “minimal connection” tests under the Commerce Clause and the Due Process Clause, respectively, would be easily satisfied. That much is settled by this Court’s decision in *Standard*

Pressed Steel, which upheld the imposition of the very tax at issue here upon an out-of-state manufacturer because of the presence in the State of a single employee who serviced a single customer. That employee performed services quite similar to, although not even as extensive as, those performed for Tyler Pipe by its independent sales representatives. In *Standard Pressed Steel*, the employee operated out of his home, consulting with the customer concerning its needs, and following up on sales after delivery of the product. Orders were sent directly to, and filled by, Standard Pressed Steel from its out-of-state home office, to which all payments were also sent.

This Court found a sufficient “nexus” for Commerce Clause purposes between the employee’s local activities in Washington and Standard Pressed Steel’s interstate sales. The opinion distinguished *Norton Co. v. Department of Revenue*, 340 U.S. 534 (1951), on which Tyler Pipe places heavy reliance, because in that case, the State had not established a sufficient factual nexus between Norton’s Chicago office and some of the sales made directly from its Worcester, Massachusetts, headquarters. The Court found that Standard Pressed Steel’s situation more closely resembled that in *General Motors Corp. v. Washington*, 377 U.S. 436 (1964), where the activities of non-selling district managers and service representatives were held sufficiently substantial “with relation to the establishment and maintenance of sales, upon which the tax was measured.” *Id.* at 447, quoted in 419 U.S. at 563.

The Court decisively rejected Standard Pressed Steel’s due process challenge to the tax as “verg[ing] on the frivolous.” 419 U.S. at 562. The Court explained that the employee “made possible the realization and continuance of valuable contractual relations between the taxpayer and its customer.” *Ibid.* In effect, the Court applied a “but for” test, upholding the tax because the Company would not have been able to make the sales on which it was being taxed but for the activities of the employee.

Similarly, in the present case, the local activities of the independent sales representatives provide a sufficient nexus to satisfy the Commerce Clause and sufficient minimal contacts to satisfy the Due Process Clause. Those sales representatives engage in substantial activity "with relation to the establishment and maintenance of sales, upon which the tax [is] measured" (*General Motors Corp.*, 377 U.S. at 447) and "[make] possible the realization and continuance of valuable contractual relations" (*Standard Pressed Steel*, 419 U.S. at 562) between Tyler Pipe and its customers in the State of Washington.

Tyler Pipe nevertheless argues that it cannot be taxed because it is represented in Washington by independent sales representatives who are not its employees. The very same formalistic argument was unsuccessfully urged in *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960), where the Court held that the Due Process Clause does not differentiate between independent sales representatives and direct employees with regard to state tax liability. In *Scripto*, the Court upheld a Florida statute requiring a Georgia company, with no full-time employees in Florida, to collect and pay use taxes for goods sold in Florida through independent sales representatives. The Court explained (*id.* at 211-12):

True, the "salesmen" are not regular employees of appellant devoting full time to its service, but we conclude that such a fine distinction is without constitutional significance. The formal shift in the contractual tagging of the salesman as "independent" neither results in changing his local function of solicitation nor bears upon its effectiveness in securing a substantial flow of goods into Florida Moreover, we cannot see, from a constitutional standpoint "that it was important that the agent worked for several principals." . . . The test is simply the nature and extent of the activities of the appellant in Florida.

As the *Scripto* decision exemplifies, this Court has examined constitutional challenges to state taxes in terms

of real situations rather than legal forms. Tyler Pipe, for reasons of its own convenience, has opted to handle its Washington sales by contractual relations with independent agents rather than through its own employees. Its Washington sales should not be exempt from state tax simply because of the form of business association through which it chooses to conduct its business.

The Court has firmly rejected any such formalistic dependence on physical presence in the State in another context, the due process requirements for a state court's exercise of jurisdiction over a nonresident defendant. There is no question that Washington state courts may assert jurisdiction over Tyler Pipe on the basis of its substantial activities there. The exercise of judicial jurisdiction satisfies due process concerns when the defendant's contacts with the forum state "proximately result from actions by the defendant *himself* that create a 'substantial connection' with [that] state." *Burger King Corp. v. Rudzewicz*, 105 S. Ct. 2174, 2184 (1985), citing *McGee v. International Life Ins. Co.*, 355 U.S. 220, 223 (1957). A defendant that "purposefully avails itself of the privilege of conducting activities within the forum state" (*Hanson v. Denckla*, 357 U.S. 235, 253 (1958)), may not avoid the jurisdiction of its courts "merely because the defendant did not *physically* enter the forum state." *Burger King*, 105 S.Ct. at 2184. Such a rule is fair because of the "inescapable fact of modern commercial life that a substantial amount of business is transacted solely by mail and wire communications across state lines, thus obviating the need for physical presence within a State in which business is conducted." *Ibid.* For the same reasons, Tyler Pipe should be required to bear its fair share of Washington's taxes. "The activities which establish [the company's] 'presence' subject it alike to taxation by the state and to suit to recover the tax." *International Shoe Co. v. Washington*, 326 U.S. 310, 321 (1945); see also *Shaffer v. Carter*, 252 U.S. 37, 49 (1920).

To permit the label that a business may place on its relationships with the agents who create its profits to obscure the benefits that these agents and the business itself receive from the State would place a premium on the creativity of the business community to devise corporate arrangements that will insulate it from paying its fair share of state taxes. This Court's encouragement of such creativity would serve no legitimate purpose, but would severely jeopardize the States' ability to raise sufficient revenue in a fair and equitable manner. Tyler Pipe's challenges to the Washington tax should therefore be rejected.

CONCLUSION

The judgments of the Washington Supreme Court should be affirmed.

Respectfully submitted,

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